S. HRG. 98-304

THE SOUTHLAND CORPORATION INVESTIGATION

HEARING

BEFORE THE

SUBCOMMITTEE ON SECURITIES

OF THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

NINETY-EIGHTH CONGRESS

FIRST SESSION

ON

JOHN FEDDERS' INVOLVEMENT IN THE INTERNAL BUSINESS ETHICS REVIEW CONDUCTED BY THE SOUTHLAND CORPORATION, WHILE OUTSIDE COUNSEL TO THE SOUTHLAND CORPORATION

JUNE 28, 1983

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THE SOUTHLAND CORP. INVESTIGATION

TUESDAY, JUNE 28, 1983

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
SUBCOMMITTEE ON SECURITIES,
Washington, D.C.

The subcommittee met at 2 p.m., in room SD-538, Dirksen Senate Office Building, Senator Alfonse M. D'Amato (chairman of the subcommittee) presiding.

Present: Senator D'Amato.

OPENING STATEMENT OF SENATOR D'AMATO

Senator D'AMATO. The Subcommittee on Securities is in session this afternoon to examine Mr. John Fedders' role in the internal ethical review conducted by the Southland Corp. in 1977. Prior to becoming the Director of the SEC's Division of Enforcement in 1981, Mr. Fedders was a partner in the Washington law firm of Arnold & Porter. In 1977 and 1978, Mr. Fedders served as outside counsel to the Southland Corp., primarily to assist it in an internal ethical review, a review which was requested by the SEC. Last month the Southland Corp., one of its executives, and a former New York City Council member were indicted by a Federal grand jury for a bribery and coverup conspiracy, which allegedly occurred during the time of Southland's internal ethical review.

The Securities Subcommittee will focus primarily on Mr. Fedders' conduct relating to the internal ethical review and, to a limited extent, Mr. Fedders' conduct relating to Southland Corp. since he joined the SEC in 1981.

This hearing is particularly pertinent, in light of the recent indictments handed down by the Federal grand jury involving Southland Corp. The grand jury found, and I quote:

> On or about and between June 22, 1977, and January 25, 1978, the defendant Southland Corp. and Eugene De Falco and persons known to the grand jury, directed, supervised and participated in an internal investigation of the company's business practice to determine whether there had been any questionable receipts, payments or political contribution by the company. During the course of this investigation, known as the business ethic review, and thereafter, persons known to the grand jury failed to disclose to the company's audit committee its independent account auditors, outside tax counsel, the SEC and others, that Eugene Mastropieri and the defendant Southland Corp. and Eugene De Falco and others, had been and continued to be engaged in a conspiracy to bribe an official or officials of a tax commission and made false statements to those persons and others.

Today's hearing will address the following issues, among others: how much did Mr. Fedders know of the alleged 1977 questionable payment of $96,500 that was turned up by Southland in its internal

probe, but which was later removed from the summary of the investigation. What role, if any, did Mr. Fedders play in the preparation of the final report on the investigation which deleted mention of the alleged bribe payment? What specific information did Mr. Fedders receive about the alleged bribery, and when did he receive it? What did Mr. Fedders do or not do in response to information about the alleged bribe?

Mr. Fedders first testified before a Federal grand jury in Ju[illegible]of 1982 as a cooperating witness and again in April of this year. It was widely reported that Mr. Fedders has become the subject of a grand jury investigation.

As chairman of the subcommittee charged with oversight of the Securities and Exchange Commission, I feel compelled to schedule this hearing. It is imperative that the subcommittee address the questions which have been raised about the conduct of the SEC's chief enforcement officer. In addition, I have been concerned that at some point in the future, the adverse publicity about the Southland case might begin to take its toll on the day-to-day functioning of the SEC's enforcement division.

I might add that in a letter dated May 31, 1983, addressed to Senator Garn and Congressman Dingell, Mr. Fedders requested the opportunity to appear before a congressional committee, in order to respond to questions and explain his conduct in this matter.

I will now swear in our witness, Mr. John Fedders.

[Witness sworn.]

TESTIMONY OF JOHN. M. FEDDERS, DIRECTOR, DIVISION OF ENFORCEMENT, SECURITIES AND EXCHANGE COMMISSION, ACCOMPANIED BY NATHAN LEWIN, ESQ., ATTORNEY AT LAW, MILLER, CASSIDY, LARROCA & LEWIN, WASHINGTON, D.C.

Mr. FEDDERS. Mr. Chairman, I have a prepared 33-page written statement. If that could be entered into the record, I am prepared to summarize it in about 20 minutes.

Senator D'AMATO. That will be entered into the record, as if read in its entirety.

Mr. FEDDERS. Mr. Chairman, I'm here at your invitation to testify on the subject of the consultation and advice I provided, as an attorney in private practice, to the Southland Corp. in 1977 and early 1978 in its conduct of a business ethics review. More specifically, my testimony concerns the investigation done by Southland into a payment of $96,500 made by it to a New York lawyer named Eugene Mastropieri, which is the subject of two indictments returned last month in the U.S. District Court for the Eastern District of New York.

I am pleased that I have this opportunity to testify in a public forum, and that I can fully and finally put to rest questions that have been raised about what I did in 1977 and 1978. I am eager, and always have been, to provide this account in its entirety. I know I acted correctly, exercising my responsibility as an attorney for a respected publicly held corporation, and that everything I did and said was lawful, ethical and proper.

I have testified completely on this subject, following Southland's specific waivers of the attorney-client privilege, in two appearances

before the Federal grand jury in Brooklyn, N.Y. On those occasions, I answered in the grand jury room every question put to me by the prosecutor relating to what I did and what I knew in 1977 and 1978. I invoked no privilege.

Southland also waived its attorney-client privilege so that I could testify on September 10, 1982, as part of a private investigation conducted by the Securities and Exchange Commission into this matter. Again, I answered on that occasion, all questions inquiring about what I did and knew in 1977 and 1978. Again, I invoked no privilege.

WAIVERS EXECUTED BY SOUTHLAND

The waivers executed by Southland in those proceedings were essential because among my legal obligations is the duty to maintain the confidences of my former client, Southland. While the grand jury was conducting its investigation in 1982, Southland instructed me, in no uncertain terms, that I could not reveal to a congressional committee Southland's confidences or any confidential matters relating to the business ethics review. I was obliged to follow those instructions.

I sought independent legal advice in order to determine the extent of my duty as a lawyer. I was told, in a carefully reasoned opinion letter which has been made available to this subcommittee, that I had no right to disobey the confidentiality instructions of my former client. Consequently, when I appeared before the House subcommittee on September 8, 1982, I testified fully about things I said or did after assuming my present post with the Commission. Southland's invocation of the attorney-client privilege, however, barred me from testifying before the House subcommittee about the business ethics review, the Mastropieri matter, and about the events of 1977 and 1978.

The Federal grand jury concluded its term in early May 1983, and before it did so, it returned two indictments. Despite more than 3 years of investigation, neither indictment charged the former general counsel of Southland, Clark J. Matthews III, or any member of Southland's legal department, with any criminal offense. It was almost exclusively Mr. Matthews, along with Michael R. Davis, a member of his staff, whom I principally advised in 1977 and 1978 in connection with the business ethics review which Southland's legal department was conducting. Nonetheless, newspaper stories appeared after these indictments in which questions were raised concerning my integrity.

Nathan Lewin, my counsel, seated to my right, was advised by the Federal prosecutor that, "out of an abundance of caution," he had decided that, along with anyone else who participated in the preparation of the business ethics review, I was a "subject" of the grand jury investigation. After the indictments were returned on May 4, another grand jury continued its investigation. My status as a "subject" was reported on May 30, 1983, in "the Washington Post," as having come from "Federal sources." It became clear to Mr. Lewin by May 30, 1983, that, under the attorneys' code of professional responsibility, my own conduct was being called into question sufficiently to warrant a public response.

I advised the ranking majority and minority members of the appropriate Senate and House committees by letter on May 31 that I now felt free to testify and that I wanted such an opportunity.

The House subcommittee indicated in conversations with Mr. Lewin that it would schedule a hearing for June 23. The House subcommittee meeting was never held. Mr. Lewin was advised that the reason was that the full committee was busy with meetings on markups of bills on June 21, 22, and 23. This subcommittee then invited me to appear. My attorney has collected and made available to this subcommittee the contemporaneous documents which refer to my participation in Southland's business ethics review in 1977 and 1978, and they have been examined by the subcommittee's counsel and are available for use today.

I know I did absolutely nothing wrong or improper in any way in the assistance I gave to Southland in connection with its business ethics review. My role in that review was to advise those who were investigating the facts. My advice could be based only on information obtained by others and repeated to me. I cannot, of course, know with certainty whether anyone misled me or lied to me in 1977 or 1978. But if certain allegations in the indictments filed on May 4, 1983, are true, some people did lie about the Mastropieri matter when they were interviewed by members of the legal department, and that misinformation was conveyed to me.

In 1976, I was a partner at Arnold & Porter and had been since 1973.

In mid-November 1976, Southland received a letter from the SEC's Division of Enforcement requesting that the corporation determine whether it had participated in any illegal or questionably illegal transactions from January 1, 1969, to the present.

Following receipt of that letter, I joined Messrs. Matthews and Davis in discussions with the SEC staff concerning the basis for their request and the schedule proposed by the Commission. Mr. Matthews thereafter agreed to submit the Division of Enforcement's request to the board of directors.

In April 1977, the request was reported to the board. The board then authorized its audit committee, in conjunction with the legal department, to explore the possibility of such an investigation. The audit committee, which was a standing committee of the Southland board, consisted of Chairman John Y. Ballard, William W. Atwell, and Mark L. Lemmon. All were outside directors of the corporation. The audit committee promptly requested the legal department to undertake an initial "limited review" to enable the committee to present a recommendation to the board.

EMPLOYEES INTERVIEWED BY LEGAL DEPARTMENT

Between late April and early June 1977, the legal department undertook a preliminary inquiry to determine whether a larger investigation should be conducted. Approximately 25 Southland employees were interviewed by the legal department during this initial period. At the legal department's request, Bud Vieth, the partner at Arnold & Porter who was the most senior attorney working on Southland matters, and I participated in three of the 25 interviews it conducted.

On June 2, 1977—the same day as these interviews were held—I met with the audit committee and with Messrs. Matthews and Davis. I explained to the committee the nature of an internal investigation of this kind and its legal context.

The audit committee met again with Mr. Matthews on June 22, 1977, immediately prior to a board of directors meeting on that day. I was not present at either meeting. The audit committee recommended to the board that a business ethics review be conducted on a companywide basis to cover activities since January 1, 1975. The board accepted that recommendation and instructed the legal department—not Arnold & Porter—to conduct such an investigation.

I must emphasize that neither Arnold & Porter nor I individually participated, at this time or at any later stage of the business ethics review, in any manner other than as a consultant available to give advice when and as needed. At no time did we conduct or supervise the business ethics review. Up to June 22, 1977, I was involved only in one, discussions with the SEC staff; two, drafting a questionnaire that might be used in case of an investigation, three, interviewing three members of the Southland staff, and four, providing oral advice to the legal department and the audit committee on the scope, structure, methodology, and legal ramifications of such an investigation.

Thereafter, my principal involvement occurred in December 1977 and January 1978 and consisted of editing the legal department's report, drafting the audit committee's letter to the board of directors, and formulating the code of business conduct which the Audit Committee recommended to the board of directors. Even these limited tasks called upon more of my time than originally had been anticipated. My role in the investigation was to provide Southland with the expertise I had developed through participation in investigations of this kind for other large corporations.

Following the decision of the board of directors on June 22, 1977, I revised a questionnaire that I had drafted in the spring when the possibility of an inquiry was being considered. It was circulated in July 1977. I did not participate directly in the circulation of the questionnaire, or in the gathering or tabulation of responses. Nor did I read any of the completed employee questionnaires.

On September 22, 1977, however, I met for several hours with Messrs. Matthews and Davis at the Arnold & Porter offices to review several pages of summaries of the affirmative responses to the questionnaire that Mr. Davis had put together. We discussed which areas required further investigation, and I suggested how the investigation should proceed.

I did not personally attend any of the interviews following that meeting, with the exception of one. Consistent with Southland's decision to keep costs low by having the legal department do the investigative work and consistent with my limited role as an adviser in the business ethics review, I was not asked to participate in 87 of the 88 interviews which Southland's staff held. I reviewed no memoranda of interviews or any corporate documents gathered during the investigation.

I was asked to conduct only one interview: That of a California lobbyist for Southland who had been paid substantial amounts on a

regular basis. That interview had nothing whatever to do with the New York legal fee which had been paid in July to Mr. Mastropieri.

Other than the September 22 meeting and the California interview, I was not substantially involved with the business ethics review during this period. Very little of my attention was spent on this matter in the summer of 1977.

Let me give you the background on the Mastropieri fee, so that you can understand its context.

At the core of the Mastropieri matter are a number of sales tax cases brought before the New York State Tax Commission. They involve the correct sales tax liability when a 7-Eleven franchise is terminated. The average amount in issue in any one case is approximately $5,000, and there were about 40 cases pending on this question.

Southland had been represented in these cases since 1972 by a Long Island, N.Y., lawyer named Thomas Dougherty. Eugene De Falco, who had been manager of the Northeastern Stores Division, supervised the litigation, and he became concerned in 1976 with the lack of progress in these cases. De Falco spoke of his concern with John Kelly, a Long Island businessman who was in the security-service field and was providing that service for Northeastern 7-Eleven stores. Kelly suggested that Eugene Mastropieri be retained.

Mastropieri then joined Dougherty as cocounsel in the sales tax cases. In July 1977, Mastropieri submitted the only bill he ever presented for his services. It was for $96,500, and De Falco sent it to Dallas, where it was paid by check.

UNORTHODOX PAYMENT PROCEDURES

Events that preceded the payment to Mastropieri were unusual and, frankly, suspicious. Prior to the presentation of the legal bill, it had been suggested to Mr. Matthews that the payment be billed as an airplane lease. Mr. Matthews rejected the suggestion out of hand and insisted that Mastropieri would be paid only if he submitted a legal bill for services, which he ultimately did. I learned later that De Falco and Dole said in their interviews that other suggestions of unorthodox payment procedures, such as a cash payment or a payment for security services, had been made. Mr. Matthews recalled only the suggestion of an airplane lease. I learned later in 1977 that Mr. Matthews became suspicious enough to inquire personally in June 1977 of Mr. Dougherty whether Mastropieri was providing professional assistance in this matter. Dougherty assured Matthews that Mastropieri was actually providing professional services.

My best recollection is that I first learned about this matter from my former partner, Bud Vieth, shortly before the September 22 meeting I had with Messrs. Matthews and Davis. The payment to Mastropieri was then viewed by me as a large legal fee paid under circumstances that justified additional investigation. I thought of it as one of several matters that would have to be followed up.

Although I do not recall the precise details, I am certain that when I met with Messrs. Matthews and Davis in Washington on

September 22, 1977, the Mastropieri fee was discussed along with the other matters that warranted investigation.

A response to the questionnaire from Eugene Pender, controller of the corporation, said that he suspected that a payment made in the northeast division to a law firm in July 1977 "was inflated to include costs other than legal fees." Mr. Pender added that "Dick Dole should have details." Mr. Dole was a senior vice president for stores. I do not recall whether this response was expressly identified by us with the Mastropieri matter, but I am certain that Messrs. Matthews, Davis, and I determined that the Mastropieri matter should be followed up with interviews of Southland employees.

Following the September 22 meeting, the Arnold & Porter time records reflect that, apart from the one interview conducted in California, little of my time was spent on Southland's business ethics review in October and November 1977.

I am confident that I learned in the months following our September 22 meeting that the legal department did interview De Falco and Frank Kitchen who was De Falco's supervisor and was manager of the northern region. I learned—although I do not recall precisely when—that De Falco had denied that there had been any impropriety whatever in the arrangement with Mastropieri. I also was told, however, that Mr. Kitchen had informed the legal department that he harbored suspicions as a result of discussions concerning the New York sales tax cases, which had occurred during a sales meeting in February 1977, attended by Messrs. De Falco, Dole, Kitchen, and John P. Thompson, Southland's chairman of the board.

In addition, I learned subsequently that the other participants in the meeting reported by Mr. Kitchen—specifically Messrs. Thompson and Dole—had been interviewed and had denied that there had been discussion of any improper use of the fee.

The audit committee met in Dallas to review the then-current status of the business ethics review on December 13, 1977, and on January 12, 1978. I was present at both meetings, and I have sketchy handwritten notes I wrote at both.

My notes of the December 13 meeting confirm my recollection that I reviewed with the audit committee a proposed outline of the report of the legal department which would be submitted to the audit committee for it to forward to the board of directors. Although the Mastropieri matter is not specifically mentioned in my two pages of handwritten notes, I am confident that the status of that investigation was discussed. Since Mastropieri had not yet been interviewed, the audit committee had before it on December 13, 1977, only the results of the interviews of Dougherty, Kitchen, Dole, Thompson, and De Falco.

Following the December 13, 1977, audit committee meeting, I did spend considerable time on this matter. Nearly all of my time was utilized in formulating the ode of business conduct that the audit committee would recommend to the board of directors, editing and revising the legal department's report to the audit committee, and drafting, at the audit committee's request, its report of conclusions and recommendations to Southland's board of directors.

MASTROPIERI FEE DROPPED FROM REPORT

I do not recall seeing or working on any draft of the legal department's report which contained a description of the Mastropieri matter. There was, therefore, no decision made by me or, to my knowledge, by anyone else to drop any discussion of the Mastropieri fee from a draft of the business ethics review report.

The March 1982 decision of the U.S. Court of Appeals for the Second Circuit refers, at various times, to the deletion of the Mastropieri matter from an early draft of the business ethics review. The opinion makes it clear, however, that these references are based entirely upon one report that Mr. Matthews had told an outside accountant that the Mastropieri payment had been deleted from an early draft of the business ethics review.

I do not know whether Mr. Matthews specifically referred to a draft of the business ethics review in the conversation reported by the accountant or whether he indicated only that the Mastropieri matter had been considered and investigated, and that a decision had been made not to include it in the report.

I do know, however, that I did not participate in any deletion of the Mastropieri matter from a draft of the business ethics review.

Mr. Matthews or Mr. Davis may have, at some time, prepared a written account of the Mastropieri matter which I read or had read to me. However, I do not specifically recall either event, and have so testified. I am certain that there was no writeup on the Mastropieri matter in any draft of the business ethics review report that I reviewed.

My recollection is that I was informed at some time after the December 13, 1977, meeting of the audit committee that Mr. Vieth and Mr. Matthews had decided that Mr. Matthews would question Mastropieri directly about his legal fee.

I was not consulted concerning whether the interview should take place, but Mr. Vieth asked me to review with Mr. Matthews how the interview should be conducted. I talked to Mr. Matthews and told him that he should begin by asking Mastropieri about the sales tax cases to learn whether Mastropieri knew the substantive area of the law, then tell him that a business ethics review was being conducted, and finally build gradually to the ultimate questions regarding possibly illegal use of the money that had been paid to him. Mr. Matthews agreed to follow that course.

I do not recall exactly when I was told the results of the interview of Mastropieri. It may not have happened until the January 12, 1978 meeting of the audit committee which I attended. But I do know that I was told that Mr. Matthews had been unable to meet Mastropieri personally because of a snowstorm in New York, and that he had conducted a telephone interview instead.

I also was told that Mastropieri demonstrated familiarity with the substance of the sales tax cases. He had explained that his fee covered litigation costs through all appeals. He had indignantly rejected any suggestion that the fee was to be used for any illegal purpose.

This brings me to the January 12, 1978, meeting of the audit committee. I recall—and my sketchy notes reflect—that the New

York situation, which was the Mastropieri fee, was a subject of discussion with the audit committee members.

Mr. Matthews reported on his interview of Mastropieri. Mr. Dole was summoned to the committee meeting twice to be questioned about the payment, and I recall at least one of the audit committee members—Mr. Atwell or Mr. Lemmon—being active during that questioning.

At the conclusion of a lengthy discussion of the Mastropieri matter, it was the view of all concerned that there was insubstantial evidence on which to base a conclusion of illegality and that the legal department would, therefore, not include the subject in its report. I believed at the time that this conclusion was reasonable. My partner, Bud Vieth, subsequently concurred in this judgment.

I continue to believe that the information that had been provided to me at that time warranted that conclusion. By January 12, 1978, the suspicious circumstances relating to the fee were as follows:

First, its size;

Second, the unusual initial request or requests for surreptitious billing;

Third, Mr. Kitchen's surmise as disclosed in his interview by Mr. Davis and in his amended questionnaire; and

Fourth, Mr. Pender's suspicion as reflected in his response to the questionnaire.

On the other hand:

First, Mr. Dougherty, the original counsel in the tax commission cases who had no reason to be pleased that Mastropieri had been retained, had assured Mr. Matthews that Mastropieri was doing legal work on the tax cases;

Second, Mr. Matthews had rejected the request for billing as an airplane lease, and a bill for legal services had been rendered and paid by check;

Third, Mr. Kitchen's surmise was based entirely on his understanding of a single conversation, and had been contradicted by all the other persons present during that conversation—Mr. Thompson, Mr. Dole and Mr. De Falco;

Fourth, Mr. Dole, the senior vice president for stores— whom Pender had identified as the person who would have details about the suspicious payment to a law firm—had denied that there was anything to be suspicious about and had withstood questioning by the audit committee at its January 1978 meeting;

Fifth, there had been no resolution of the cases pending before the New York State Tax Commission, notwithstanding the payment to Mastropieri a full 6 months earlier; and

Sixth, Mastropieri had personally denied to Mr. Matthews any illegality, had shown personal familiarity with the issues in the cases, and had explained that the fee covered future phases of the litigation.

Notwithstanding the consensus that the Mastropieri matter need not be included in the legal department's report, it was agreed that the subject should be reported orally to the board of directors by Mr. Matthews. I concurred in that judgment as well.

OTHER LEGAL MATTERS

There were other legal issues discussed with me at or about the time of January 12. I recall Messrs. Matthews and Davis raising the question whether there should be public disclosure of the business ethics review report and whether disclosure to the SEC was needed in connection with any required SEC filing. There had been no commitment to the SEC that any report would be submitted to the agency. The legal department's view, reflected in the final version of the business ethics review report, was that the "matters reported * * * were not material in relation to the company's overall operations."

I agreed that this view was reasonable, and concurred that there need be no disclosure. My judgment then was—as it is today—that there was no substantial likelihood that the disclosure of the information in the report would be viewed by reasonable shareholders or investors as having significantly altered the total mix of information then made available by Southland.

I also was consulted on the question of retention of drafts of the legal department's report. I had instructed the legal department to retain corporate documents secured during the investigation, as well as completed questionnaires and notes and memoranda of interviews.

When the investigation process drew to its close, I was asked whether this retention instruction applied to drafts of the legal department's business ethics review. I replied that it did not.

Absent a legal duty to retain, it has been my practice to discard drafts of my work. I believed it to be a sound general policy which was applicable to this instance. A good lawyer lets the final version of his work speak for itself. Drafts only create ambiguities and raise doubts where none are intended.

Consequently, I advised the legal department that at Arnold & Porter we would discard all drafts, and I recommended that Southland do the same. I insisted, however, that corporate documents be retained and suggested that documents relating to the Mastropieri matter be kept separately from those which related to what was discussed in the report.

On January 25, 1978, Southland's board of directors met. One purpose of the meeting was to receive the legal department's and the audit committee's reports on the business ethics review.

Mr. Vieth and I attended that meeting, along with Messrs. Matthews and Davis and the members of the audit committee. The audit committee presented its report to the board, stated its conclusions, and proposed future preventive action by Southland, including implementation of the code of business conduct that I had drafted. Mr. Matthews described the business ethics review, discussing the subjects covered by the legal department's report.

Mr. Matthews then reported orally to the board on the Mastropieri matter. He explained that while there were some suspicious circumstances, the legal department had been unable to determine that the fee was used for any illegal purpose. As a result, it had not been included in the report. His oral statement was accepted by the board, which agreed with the disposition of the matter.

I addressed the board on the scope, structure and methodology of the investigation. Mr. Vieth also addressed the board and concurred in the legal department's conclusion, which had been reported by Mr. Matthews to the board, that public disclosure of the report was not required.

NEW ALLEGATIONS IN GRAND JURY INVESTIGATION

Between January 25, 1978 and February 21, 1978, I charged only 5 hours to this matter. Thereafter, I had nothing further to do with it until Arnold & Porter began representing Southland and its officials in April 1980 in connection with the grand jury investigation of the Mastropieri fee conducted in the eastern district of New York.

I did not, by the way, participate in any way in Southland's December 1978 underwritten public offering of $75 million in sinking fund debentures. Arnold & Porter has not, to my knowledge, ever represented Southland in any underwritten public securities offering, and it did not represent Southland in this one.

Neither I nor any other Arnold & Porter attorney participated in any way, therefore, in a decision about whether to disclose to Touche Ross & Co., Southland's independent public accountants, or to White & Case, the underwriters' counsel in the December 1978 offering, either (1) the business ethics review or (2) the Mastropieri matter.

I learned for the first time after April 1980 that the business ethics review had been shown to Touche Ross & Co. and to White & Case in 1978.

There have, of course, been allegations made in the indictment returned against Southland and De Falco on May 4 which describe events of which I had no knowledge—and could have had no knowledge—in 1977 and 1978. The indictment alleges an elaborate process whereby $20,000 of the Mastropieri fee was placed in a Canadian bank, allegedly "to be used as a slush fund from which a bribe was to be paid to an official or officials of the tax commission."

I had no knowledge of such alleged laundering of funds, and I had no way of discovering such actions, if they in fact occurred.

Indeed, according to the indictment, several of these actions occurred after the business ethics review was completed. Nor did I have any knowledge of other facts alleged in the indictment, such as the allegation that Mastropieri had agreed to "kick back a substantial portion" of his fee to De Falco.

There were other allegations that I first heard when I testified before the grand jury on June 24, 1982. First, I was asked whether I had been informed of handwritten notes, in what appeared to be Mr. Matthews' writing, indicating that $40,000 of Mastropieri's fee might be "spread among members of the tax commission."

I definitely had not been told of any such handwritten notes. Nor did I see any such notes until they were shown to me in the grand jury room on June 24. Although Mr. Matthews reported to the board that the legal department had investigated the possibility of a bribe, there was no discussion, suggestion, or implication that

$40,000 might be "spread among the members of the tax commission" at any of the meetings I attended.

Second, I was never told by anyone that a member of the New York State Tax Commission had recommended that Southland retain Mastropieri. That proposition was first put to me by the prosecutor during my grand jury testimony, and I denied them—and deny now—ever having heard such a report from anyone other than the Federal prosecutor.

The fact is that Southland was conducting an internal investigation in 1977 and 1978 with all the limitations that private parties have in performing such a task. It had no subpena power and no ability to force individuals to tell the truth. I acknowledge that if Southland had then had the government's power to subpena witnesses and to compel truthful testimony, further investigation might have uncovered additional relevant facts. It had no such power, and I was limited to the information provided to me by the legal department.

On the basis of the information provided to the audit committee, to Mr. Vieth and to me, a good faith and honest decision was made on the Mastropieri matter. I do not, of course, know all the evidence that the Federal prosecutors have. If that evidence supports the allegations made in the indictment, obviously, there are substantially more grounds for suspicion that we, as private parties, had over 5 years ago.

My own review of the full history of the Southland business ethics review and its investigation of the Mastropieri payment leaves me with the solid feeling that I carried out my responsibilities in it with the same personal qualities I seek to apply to all my professional endeavors. I approached that particular task with vigor, enthusiasm, and integrity. I applied to the evidence presented to me by the legal department the same balance of healthy skepticism, informed judgment and good faith I have been applying to legal problems ever since I proudly entered upon the practice of law. Anyone who doubts this simply does not know me.

If the allegations in the indictments are true, it now appears that some of the individuals interviewed by Southland's legal department lied. Had I known then what the prosecutor indicates he knows now, I would have recommended that the investigation continue. And had I then been satisfied that the allegations now made in the indictment were true, I would have urged that the Mastropieri payment be reported in the business ethics review, or to appropriate authorities.

It is not hard to second-guess an investigation—even one that is conducted by Government officials who have subpena power and the authority to prosecute for perjury. I cannot say, therefore, that Southland's investigation of the Mastropieri matter was perfect.

I can say, however, that the fact that the U.S. attorney for the eastern district of New York was able, after an arduous investigation of more than 3 years, to indict Southland and one of its employees, Eugene De Falco, for conspiracy does not mean that everyone involved with Southland's own 4-month investigation of this incident was corrupt or participated in a coverup. For myself, I am sure of one thing—every decision that I made during the business ethics review was made honestly, with care and integrity.

I hope that responsible authorities will bring this matter to a quick conclusion so that the public will be assured, as I know it will, that my own conduct was correct and lawful and that my testimony on all occasions was truthful.

That completes my prepared statement. I will be glad to answer any questions you may have on this subject. Thank you.

[The complete statement follows:]

STATEMENT OF JOHN M. FEDDERS

BEFORE THE

SUBCOMMITTEE ON SECURITIES

OF THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

OF THE

UNITED STATES SENATE

June 28, 1983

Senator D'Amato and Members of the Subcommittee:

I am here at your invitation to testify on the subject of the consultation and advice I provided, as an attorney in private practice, to The Southland Corporation in 1977 and early 1978 in its conduct of a "Business Ethics Review." More specifically, my testimony concerns the investigation done by Southland into a payment of $96,500 made by it to a New York lawyer named Eugene Mastropieri, which is the subject of two indictments returned last month in the United States District Court for the Eastern District of New York.

I.

MY EARLIER TESTIMONY

I am pleased that I have this opportunity to testify in a public forum, and that I can fully and finally put to rest questions that have been raised about what I did in 1977 and 1978. I am eager, and always have been, to provide this account in its entirety. I know I acted correctly, exercising my responsibility as an attorney for a respected publicly held corporation, and that everything I did and said was lawful, ethical and proper.

I have testified completely on this subject, following Southland's specific waivers of the attorney-client privilege, in two appearances before the federal grand jury in Brooklyn, New York. On those occasions, I answered in the grand jury room every question put to me by the prosecutor relating to what I did and what I knew in 1977 and 1978. I invoked no privilege.

Southland also waived its attorney-client privilege so that I could testify on September 10, 1982 as part of a private investigation conducted by the Securities and Exchange Commission into this matter. Again, I answered on that occasion all questions inquiring about what I did and knew in 1977 and 1978. Again, I invoked no privilege. 1/

1/ Copies of Southland's written waivers of the attorney-client privilege to enable me to testify on these occasions have been filed with the Subcommittee. They are dated April 29, 1982, September 10, 1982, and April 18, 1983.

The waivers executed by Southland in those proceedings were essential because among my legal obligations is the duty to maintain the confidences of my former client, Southland. While the grand jury was conducting its investigation in 1982, Southland instructed me, in no uncertain terms, that I could not reveal to a Congressional committee Southland's confidences or any confidential matters relating to the Business Ethics Review. 2/ I was obliged to follow those instructions.

I sought independent legal advice in order to determine the extent of my duty as a lawyer. I was told, in a carefully reasoned opinion letter 3/ which has been made available to this Subcommittee, that I had no right to disobey the confidentiality instructions of my former client. Consequently, when I appeared before the House Subcommittee on September 8, 1982, I testified fully about things I said or did after assuming my present post with the Commission. Southland's invocation of the attorney-client privilege, however, barred me from testifying before the

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2/ Those instructions were contained in letters dated June 17, 1982 and September 7, 1982, which have been filed with the Subcommittee.

3/ See the June 21, 1982, letter from Nathan Lewin of Miller, Cassidy, Larroca & Lewin to me. Mr. Lewin also wrote Congressman John D. Dingell, Chairman of the Subcommittee on Oversight and Investigation of the Committee on Energy and Commerce of the United States House of Representatives, on this subject on September 3, 1982. In addition, on February 17, 1983, he wrote to the House Subcommittee in response to a September 3, 1982, memorandum from The Congressional Research Service. Copies of these letters have been provided to this Subcommittee.

House Subcommittee about the Business Ethics Review, the Mastropieri matter, and about the events of 1977 and 1978.

II.

MY PRESENT TESTIMONY

The federal grand jury concluded its term in early May 1983, and before it did so, it returned two indictments. 4/ Despite more than three years of investigation, neither indictment charged the former General Counsel of Southland, Clark J. Matthews, III, or any member of Southland's Legal Department, with any criminal offense. It was almost exclusively Mr. Matthews, along with Michael R. Davis, a member of his staff, whom I principally advised in 1977 and 1978 in connection with the Business Ethics Review which Southland's Legal Department was conducting. Nonetheless, newspaper stories appeared after these indictments in which questions were raised concerning my integrity.

Nathan Lewin, my counsel, was advised by the federal prosecutor that, "out of an abundance of caution," he had decided that, along with anyone else who participated in the preparation

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4/ One of the indictments returned on May 4, 1983 was against Southland and its employee, Eugene DeFalco. Southland and DeFalco were charged with violating 18 U.S.C. § 371 (conspiracy); DeFalco was also charged with violations of 18 U.S.C. § 1341 and § 1343 (mail and wire fraud). The second indictment was against Eugene Mastropieri charging violations of the same federal statutes. Neither indictment alleged that a bribe had been paid. I understand that a trial on the Southland indictment has been scheduled for September 1983.

of the Business Ethics Review, I was a "subject" of the grand jury investigation 5/ within the meaning of the United States Attorney's Manual. After the indictments were returned on May 4, another grand jury continued the investigation. My status as a "subject" was reported on May 30, 1983 in The Washington Post, as having come from "federal sources." It became clear to Mr. Lewin by May 30, 1983 that, under the attorneys' Code of Professional Responsibility, DR 4-101(C)(4), 6/ my own conduct was being called into question sufficiently to warrant a public response, notwithstanding Southland's assertion of the attorney-client privilege. Mr. Lewin then told me of his conclusion.

I advised the ranking majority and minority members of the appropriate Senate and House Committees by letter on May 31 that I now felt free to testify and that I wanted such an opportunity. Southland came to this view as well. On May 31, 1983, it explicitly authorized me to testify about my "activities on behalf of Southland during the Business Ethics Review in 1977

5/ The United States Attorney's Manual (Title 9, Section 11.250) defines "subject" as "a person whose conduct is within the scope of the grand jury's investigation." A "target" is "a person as to whom the prosecutor or the grand jury has substantial evidence linking him to the commission of a crime and who, in the judgment of the prosecutor, is a putative defendant." No one has ever suggested that I am a "target" of the grand jury's investigation.

6/ This provision authorizes a lawyer to reveal "confidences or secrets necessary . . . to defend himself . . . against an accusation of wrongful conduct." An explanatory note adds, however that "he should not . . . disclose more than is necessary for his own protection."

and 1978." 7/ The House Subcommittee indicated in conversations with Mr. Lewin that it would schedule a hearing for June 23. 8/ The House Subcommittee meeting was never held; Mr. Lewin was advised that the reason was that the full Committee was busy with meetings on mark-ups of bills on June 21, 22 and 23. This Subcommittee then invited me to appear. My attorney has collected and made available to this Subcommittee the contemporaneous documents which refer to my participation in Southland's Business Ethics Review in 1977 and 1978, and they have been examined by the Subcommittee's counsel and are available for use today. The Subcommittee has also been given access to my September, 1982 testimony before an officer of the Securities and Exchange Commission. I am here, ready and eager to recount the relevant events and to answer all questions you may have on this subject.

I know I did absolutely nothing wrong or improper in any way in the assistance I gave to Southland in connection with its Business Ethics Review. My role in that Review was to advise

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7/ This authorization is included in a May 31, 1983, letter to me from Peter K. Bleakley of Arnold & Porter, which has been filed with the Subcommittee.

8/ At the House Subcommittee's request, Mr. Lewin sent copies of the letters conveying Southland's instructions on the attorney-client privilege question, and he volunteered to gather for examination by the House Subcommittee staff the documents written in 1977 and 1978 which referred to my participation in Southland's Business Ethics Review. It was agreed that in order not to prejudice the upcoming Southland trial, these documents would be made available but not copied.

those who were investigating the facts. My advice could be based only on information obtained by others and repeated to me. I cannot, of course, know with certainty whether anyone misled me or lied to me in 1977 or 1978. But if certain allegations in the indictments filed on May 4, 1983 are true, some people did lie about the Mastropieri matter when they were interviewed by members of the Legal Department, and that misinformation was conveyed to me. I am here to testify, however, about what I knew and what I did, and not to speculate about what others may have known, believed or concealed.

III.

SOUTHLAND'S PRELIMINARY CONSIDERATION
OF A BUSINESS ETHICS REVIEW

In 1976, I was a partner at Arnold & Porter, and had been there since January 1973. Southland was one of the firm's long-time clients to whom I had provided legal counsel, although I was not the partner-in-charge of the Southland account.

In mid-November 1976, Southland received a letter from the SEC's Division of Enforcement requesting that the Corporation determine whether it had participated in any "illegal or questionably illegal transactions . . . from January 1, 1969 to the present." The Division of Enforcement was making similar requests for internal investigations by other major corporations at the time. As a private attorney specializing in securities law with a leading Washington law firm, I had developed expertise

in this area. I participated in numerous internal investigations of this kind while I was in private practice.

Following receipt of that letter, I joined Messrs. Matthews and Davis in discussions with the SEC staff concerning the basis for their request and the schedule proposed by the Commission. Mr. Matthews thereafter agreed to submit the Division of Enforcement's request to the Board of Directors.

In April 1977, the request was reported to the Board. The Board then authorized its Audit Committee, in conjunction with the Legal Department, to explore the possibility of such an investigation. The Audit Committee, which was a standing committee of the Southland Board, consisted of Chairman John Y. Ballard, William W. Atwell and Mark L. Lemmon. All were outside directors of the corporation. The Audit Committee promptly requested the Legal Department to undertake an initial "limited review" to enable the Committee to present a recommendation to the Board.

IV.

ARNOLD & PORTER'S ROLE IN THE BUSINESS ETHICS REVIEW

Between late April and early June 1977, the Legal Department undertook a preliminary inquiry to determine whether a larger investigation should be conducted. Approximately 25 Southland employees were interviewed by the Legal Department during this initial period. At the Legal Department's request,

Bud Vieth, the partner at Arnold & Porter who was the most senior attorney working on Southland matters, and I participated in three of the 25 interviews it conducted. (All three of the interviews took place on one morning in Dallas, Texas, at the headquarters of Southland.) On June 2, 1977 -- the same day as these interviews were held -- I met with the Audit Committee and with Messrs. Matthews and Davis. I explained to the Committee the nature of an internal investigation of this kind and its legal context.

The Audit Committee met again with Mr. Matthews on June 22, 1977, immediately prior to a Board of Directors meeting on that day. I was not present at either meeting. The Audit Committee recommended to the Board that a Business Ethics Review be conducted on a company-wide basis to cover activities since January 1, 1975. The Board accepted that recommendation and instructed the Legal Department -- not Arnold & Porter -- to conduct such an investigation.

I must emphasize that neither Arnold & Porter nor I individually participated, at this time or at any later stage of the Business Ethics Review, in any manner other than as a consultant available to give advice when and as needed. At no time did we conduct or supervise the Business Ethics Review. Up to June 22, 1977, I was involved only in (1) discussions with the SEC staff, (2) drafting a questionnaire that might be used in case of an investigation, (3) interviewing three members of the Southland staff, and (4) providing oral advice to the Legal

Department and the Audit Committee on the scope, structure, methodology and legal ramifications of such an investigation. Thereafter, my principal involvement occurred in December, 1977 and January, 1978, and consisted of editing the Legal Department's report, drafting the Audit Committee's letter to the Board of Directors, and formulating the Code of Business Conduct which the Audit Committee recommended to the Board of Directors. Even these limited tasks called upon more of my time than originally had been anticipated.

My role in the investigation was to provide Southland with the expertise I had developed through participation in investigations of this kind for other large corporations. Had I been asked to supervise or direct the investigation myself, it would have involved much more of my own time (which I had committed to other clients) and that of other Arnold & Porter partners and/or associates. It also would have been substantially more expensive to the Corporation. Southland decided that its own Legal Department would conduct the investigation, and that the Corporation would seek help from Arnold & Porter as needed.

V.

CIRCULATION AND REVIEW OF THE QUESTIONNAIRE

Following the decision of the Board of Directors on June 22, 1977, I revised a questionnaire that I had drafted in the Spring when the possibility of an inquiry was being considered. It was circulated in July 1977 by Southland to 338

executive and managerial employees. The questionnaire sought information on, among other things, any questionable payments to government officials, federal and state political contributions, commercial bribes, kickbacks, discounts and rebates, and off-book or inaccurately accounted for funds. It was more widely distributed than any other similar questionnaire with which I have been involved. I did not participate directly in the circulation of the questionnaire, or in the gathering or tabulation of responses. Nor did I read any of the completed employee questionnaires.

On September 22, 1977, however, I met for several hours with Messrs. Matthews and Davis at the Arnold & Porter offices to review several pages of summaries of the affirmative responses to the questionnaire that Mr. Davis had put together. We discussed which areas required further investigation, and I suggested how the investigation should proceed.

I did not personally attend any of the interviews following that meeting, with the exception of one. Consistent with Southland's decision to keep costs low by having the Legal Department do the investigative work and consistent with my limited role as an advisor in the Business Ethics Review, I was not asked to participate in 87 of the 88 interviews which Southland's legal staff held. I reviewed no memoranda of interviews or any corporate documents gathered during the investigation.

I was asked to conduct only one interview -- that of a California lobbyist for Southland who had been paid substantial amounts on a regular basis. The lobbyist was not a Southland employee, and since Mr. Davis was relatively new to the company and had limited experience in investigations of this kind, Mr. Matthews asked that I assist in the interview. It fit in with my schedule, and I traveled to California to conduct that interview, together with Mr. Davis, in October, 1977. He and I concluded that the consultant had not engaged in any improper activities on behalf of Southland, and we so advised Mr. Matthews. That interview had nothing whatever to do with the New York legal fee which had been paid in July to Mr. Mastropieri.

Other than the September 22 meeting and the California interview, I was not substantially involved with the Business Ethics Review during this period, as is demonstrated by the time records maintained at Arnold & Porter. They show that I spent two hours of my time on the Southland Business Ethics Review in July, no time in August, and eight hours in September (of which six were spent on September 22, 1977, in the review with Messrs. Matthews and Davis of the results of the questionnaire). Except for July and August 1977, when I was away from my office for an extended period, my normal practice was to account for at least 200 billable hours per month while I was with Arnold & Porter. So you can see that very little of my attention was being spent on this matter in the summer of 1977.

VI.

BACKGROUND OF THE PAYMENT TO MASTROPIERI

Let me, at this point, give you background on the Mastropieri fee, so that you can understand its context.

At the core of the Mastropieri matter are a number of sales tax cases brought before the New York State Tax Commission. They involve the correct sales tax liability when a 7-Eleven franchise is terminated. The average amount in issue in any one case is approximately $5,000, and there were about 40 cases pending on this question.

Southland had been represented in these cases since 1972 by a Long Island, New York, lawyer named Thomas Dougherty. Eugene DeFalco, who had been manager of the Northeastern Stores Division, supervised the litigation, and he became concerned in 1976 with the lack of progress in these cases. DeFalco spoke of his concern with John Kelly, a Long Island businessman who was in the security-service field and was providing that service for Northeastern 7-Eleven stores. Kelly suggested that Eugene Mastropieri be retained.

Mastropieri then joined Dougherty as co-counsel in the sales tax cases. In July 1977, Mastropieri submitted the only bill he ever presented for his services. It was for $96,500, and DeFalco sent it to Dallas, where it was paid by check.

Events that preceded the payment to Mastropieri were unusual and, frankly, suspicious. Prior to presentation of the legal bill, it had been suggested to Mr. Matthews that the

payment be billed as an airplane lease. Mr. Matthews rejected the suggestion out of hand and insisted that Mastropieri would be paid only if he submitted a legal bill for services, which he ultimately did. 9/ I learned later in 1977 that Mr. Matthews became suspicious enough to inquire personally in June 1977 of Mr. Dougherty whether Mastropieri was providing professional assistance in this matter. Dougherty assured Matthews that Mastropieri was actually providing professional services.

VII.

MY FIRST RECOLLECTIONS REGARDING MASTROPIERI

My best recollection is that I first learned about this matter from my former partner Bud Vieth shortly before the September 22 meeting I had with Messrs. Matthews and Davis. The payment to Mastropieri was then viewed by me as a large legal fee paid under circumstances that justified additional investigation. I thought of it as one of several matters that would have to be followed up.

Although I do not now recall the precise details, I am certain that when I met with Messrs. Matthews and Davis in Washington on September 22, 1977, the Mastropieri fee was discussed along with the other matters that warranted investiga-

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9/ I learned later that DeFalco and Dole said in their interviews that other suggestions of unorthodox payment procedures, such as a cash payment or a payment for security services, had been made. Mr. Matthews recalled only the suggestion of an airplane lease.

tion. A response to the questionnaire from Eugene Pender, Controller of the Corporation, said that he suspected that a payment made in the Northeast Division to a law firm in July 1977 "was inflated to include costs other than legal fees." Mr. Pender added that "Dick Dole should have details." Mr. Dole was a Senior Vice President for Stores. I do not now recall whether this response was expressly identified by us with the Mastropieri payment, but I am certain that Messrs. Matthews, Davis and I determined that the Mastropieri matter should be followed up with interviews of Southland employees. That same course -- questioning of Southland personnel to pursue leads provided by the questionnaire responses -- was the course followed by the Legal Department in the other areas under investigation.

VIII.

ADDITIONAL INFORMATION
ON THE MASTROPIERI PAYMENT

Following the September 22 meeting, the Arnold & Porter time records reflect that, apart from the one interview conducted in California, little of my time was spent on Southland's Business Ethics Review in October and November 1977. For October, 14 hours (which includes eight hours for the interview of the California lobbyist on October 12) are shown, and in November 6 ½ hours are reflected. I believe, however, that I was advised on the telephone from time-to-time about the progress of various aspects of the investigation.

I am confident that I learned in the months following our September 22 meeting that the Legal Department did interview DeFalco and Frank Kitchen, who was DeFalco's supervisor and was manager of the Northern Region. I learned -- although I do not recall precisely when -- that DeFalco had denied that there had been any impropriety whatever in the arrangement with Mastropieri. I also was told, however, that Mr. Kitchen had informed the Legal Department that he harbored suspicions as a result of discussions concerning the New York sales tax cases which had occurred during a sales meeting in February 1977 attended by Messrs. DeFalco, Dole, Kitchen and John P. Thompson (Southland's Chairman of the Board). 10/ In addition, I learned subsequently that the other participants in the meeting reported

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10/ Kitchen was interviewed by Mr. Davis in October 1977, and for the first time disclosed his suspicion. At Mr. Davis' suggestion, he amended his questionnaire answer to add the suspicion. I do not recall ever seeing the actual text of his amended questionnaire. The United States Court of Appeals for the Second Circuit, however, in an April 1983 opinion, quoted Kitchen as saying that "[d]uring the course of the [February 1977] meeting, I surmized [sic] that a payment was going to be made to a state official for favorable treatment in a . . . tax liability case." In re Matter of Frank Kitchen, 83-6083 (2nd Cir. April 27, 1983).

The Court of Appeals recounts that Mr. Kitchen subsequently testified that his "surmise" was not based on anything said at the meeting, but in fact was premised solely on subsequent conversations he had with DeFalco. The prosecutor sought to have Mr. Kitchen held in contempt because his grand jury testimony was allegedly at odds with his questionnaire response and with Mr. Davis' recollection of his interview with Mr. Kitchen. The Court of Appeals, however, rejected this claim. In an opinion dated April 27, 1983, it reversed Mr. Kitchen's contempt citation. See In re Matter of Frank Kitchen, No. 83-6083 (2d Cir. 1983).

by Mr. Kitchen -- specifically Messrs. Thompson and Dole -- had been interviewed and had denied that there had been discussion of any improper use of the fee.

IX.

THE DECEMBER 1977 AUDIT COMMITTEE MEETING

The Audit Committee met in Dallas to review the then-current status of the Business Ethics Review on December 13, 1977 and on January 12, 1978. I was present at both meetings, and I have sketchy handwritten notes I wrote at both.

My notes of the December 13 meeting confirm my recollection that I reviewed with the Audit Committee a proposed outline of the report of the Legal Department which would be submitted to the Audit Committee for it to forward to the Board of Directors. Although the Mastropieri matter is not specifically mentioned in my two pages of handwritten notes, I am confident that the status of that investigation was discussed. Since Mastropieri had not yet been interviewed, the Audit Committee had before it on December 13, 1977, only the results of the interviews of Dougherty, Kitchen, Dole, Thompson and DeFalco.

X.

THE DRAFTING AND REVISION OF THE LEGAL DEPARTMENT'S REPORT

Following the December 13, 1977 Audit Committee meeting, I did spend considerable time on this matter. 11/ Nearly all of my time was utilized in (1) formulating the Code of Business Conduct that the Audit Committee would recommend to the Board of Directors, (2) editing and revising the Legal Department's report to the Audit Committee, and (3) drafting, at the Audit Committee's request, its report of conclusions and recommendations to Southland's Board of Directors. The Legal Department's report was a 71-page document which discussed, in some detail, "Political Contributions" (10 pages), "Discounts Paid" (15 pages), "Discounts Received" (11 pages), and "Other Activities" (4 pages), which included gifts to customers, suppliers and others. It also contained detailed charts and tables, which required the compilation of substantial data. The Audit Committee's report to the Board is a six-page single-spaced letter dated January 25, 1978. It contains a summary of the Legal Department's report, and includes a brief background of the investigation, conclusions and specific recommendations to

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11/ Arnold & Porter's time records reflect that in December 1977, I spent 99 1/2 hours, in January 1978, 88 3/4 hours and in February 1978, 3 3/4 hours on this matter. During the exceedingly busy period from December 9, 1977, through January 12, 1978, I devoted 154 1/2 hours to Southland.

Southland's Board made in light of the findings during the Business Ethics Review.

XI.

NO DRAFT INCLUDED THE MASTROPIERI MATTER

I do not recall seeing or working on any draft of the Legal Department's report which contained a description of the Mastropieri matter. There was, therefore, no decision made by me or, to my knowledge, by anyone else to "drop" any discussion of the Mastropieri fee from a draft of the Business Ethics Review report.

The March 1982 decision of the United States Court of Appeals for the Second Circuit refers, at various times, to the "deletion" of the Mastropieri matter from an early draft of the Business Ethics Review. 12/ The opinion makes it clear, however, that these references are based entirely upon one report that Mr. Matthews had told an outside accountant that the Mastropieri payment had been "deleted" from an "early draft" of the Business Ethics Review. I do not know whether Mr. Matthews specifically referred to a "draft" of the Business Ethics Review in the conversation reported by the accountant or whether he indicated only that the Mastropieri matter had been considered and investigated, and that a decision had been made not to include it in the report. I do know, however, that I did not participate in

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12/ In re John Doe Corp., 675 F.2d 482, 486, 491 (2d Cir. 1982).

any "deletion" of the Mastropieri matter from a draft of the Business Ethics Review.

Mr. Matthews or Mr. Davis may have, at some time, prepared a written account of the Mastropieri matter which I read or had read to me. However, I do not specifically recall either event, and have so testified. I am certain that there was no write-up on the Mastropieri matter in any draft of the Business Ethics Review report that I reviewed.

XII.

THE INTERVIEW OF MASTROPIERI

My recollection is that I was informed at some time after the December 13, 1977 meeting of the Audit Committee that Mr. Vieth and Mr. Matthews had decided that Mr. Matthews would question Mastropieri directly about his legal fee. I was not consulted concerning whether the interview should take place, but Mr. Vieth asked me to review with Mr. Matthews how the interview should be conducted. I talked to Mr. Matthews and told him that he should begin by asking Mastropieri about the sales tax cases to learn whether Mastropieri knew the substantive area of the law, then tell him that a Business Ethics Review was being conducted, and finally build gradually to the ultimate questions regarding possibly illegal use of the money that had been paid to him. Mr. Matthews agreed to follow that course.

I do not recall exactly when I was told the results of the interview of Mastropieri. It may not have happened until the

January 12, 1978 meeting of the Audit Committee which I sttended. But I do know that I was told that Mr. Matthews had been unable to meet Mastropieri personally because of a snowstorm in New York, and that he had conducted a telephone interview instead. I also was told that Mastropieri demonstrated familiarity with the substance of the sales tax cases. He had explained that his fee covered litigation costs through all appeals. He had indignantly rejected any suggestion that the fee was to be used for any illegal purpose.

XIII.

THE JANUARY 1978 AUDIT COMMITTEE MEETING

This brings me to the January 12, 1978 meeting of the Audit Committee. I recall -- and my sketchy notes reflect -- that the "New York situation" (which was the Mastropieri fee) was a subject of discussion with the Audit Committee members. Mr. Matthews reported on his interview of Mastropieri. Mr. Dole was summoned to the Committee meeting twice to be questioned about the payment, and I recall at least one of the Audit Committee members -- Mr. Atwell or Mr. Lemmon -- being active during that questioning.

At the conclusion of a lengthy discussion of the Mastropieri matter, it was the view of all concerned that there was insubstantial evidence on which to base a conclusion of illegality and that the Legal Department would, therefore, not include the subject in its report. I believed at the time that

this conclusion was reasonable. My partner, Bud Vieth, subsequently concurred in this judgment.

I continue to believe that the information that had been provided to me at that time warranted that conclusion. By January 12, 1978, the suspicious circumstances relating to the fee were:

(1) its size;

(2) the unusual initial request or requests for surreptitious billing;

(3) Mr. Kitchen's "surmise" as disclosed in his interview by Mr. Davis and in his amended questionnaire; and

(4) Mr. Pender's "suspicion" as reflected in his response to the questionnaire.

On the other hand:

(1) Mr. Dougherty, the original counsel in the Tax Commission cases who had no reason to be pleased that Mastropieri had been retained, had assured Mr. Matthews that Mastropieri was doing legal work on the tax cases;

(2) Mr. Matthews had rejected the request for billing as an airplane lease, and a bill for legal services had been rendered and paid by check;

(3) Mr. Kitchen's "surmise" was based entirely on his understanding of a single conversation, and had been contradicted by <u>all</u> the other persons present during that conversation -- Mr. Thompson, Mr. Dole and Mr. DeFalco;

(4) Mr. Dole, the Senior Vice President for Stores -- whom Pender had identified as the person who would have "details" about the suspicious payment to a law firm -- had denied that there was anything to be suspicious about and had withstood questioning by the Audit Committee at its January 1978 meeting;

(5) there had been no resolution of the cases pending before the New York State Tax Commission, notwithstanding the payment to Mastropieri a full six months earlier; and

(6) Mastropieri had personally denied to Mr. Matthews any illegality, had shown personal familiarity with the issues in the cases, and had explained that the fee covered future phases of the litigation.

In addition to the insubstantiality of evidence of illegality, a factor in my mind -- which I believe I communicated to the Legal Department and to the Audit Committee -- was that a conclusion that a bribe had been paid or planned, if expressed in a report of this kind, could be the basis of a defamation action. Before including in such a report any implication that a lawyer who had received a fee had intended to use it for a bribe to the New York State Tax Commission, more substantial evidence of wrongdoing than we had in January 1978 was required.

Notwithstanding the consensus that the Mastropieri matter need not be included in the Legal Department's report, it was agreed that the subject should be reported orally to the Board of Directors by Mr. Matthews. I concurred in that judgment as well.

XIV.

OTHER LEGAL ISSUES
DISCUSSED IN JANUARY 1978

There were other legal issues discussed with me at or about the time of the January 12, 1978 Audit Committee meeting. I recall Messrs. Matthews and Davis raising the question whether there should be public disclosure of the Business Ethics Review report and whether disclosure to the SEC was needed in connection with any required SEC filing. There had been no commitment to the SEC that any report would be submitted to the agency. The Legal Department's view, reflected in the final version of the Business Ethics Review report, was that the "matters reported . . . were not material in relation to the Company's overall operations." This was the view expressed by the Legal Department to the Audit Committee and by Mr. Vieth on behalf of Arnold & Porter to the Board. I agreed that this view was reasonable, and concurred that there need be no disclosure. My judgment then was -- as it is today -- that there was no substantial likelihood that the disclosure of the information in the report would be viewed by reasonable shareholders or investors as having significantly altered the total mix of information then made available by Southland.

I also was consulted on the question of retention of drafts of the Legal Department's report. I had instructed the Legal Department to retain corporate documents secured during the investigation, as well as completed questionnaires and notes and

memoranda of interviews. I have co-authored a law review article on this subject that appeared in The Notre Dame Lawyer. 13/

When the investigation process drew to its close, I was asked whether this retention instruction applied to drafts of the Legal Department's Business Ethics Review report. I replied that it did not. Absent a legal duty to retain, it has been my practice to discard drafts of my work. I believed it to be a sound general policy which was applicable to this instance. A good lawyer lets the final version of his work speak for itself. Drafts only create ambiguities and raise doubts where none are intended. Consequently, I advised the Legal Department that at Arnold & Porter we would discard all drafts, and I recommended that Southland do the same. I insisted, however, that corporate documents be retained and suggested that documents relating to the Mastropieri matter be kept separately from those which related to what was discussed in the report.

XV.

THE MEETING OF THE BOARD OF DIRECTORS

On January 25, 1978, Southland's Board of Directors met. One purpose of the meeting was to receive the Legal Department's and the Audit Committee's reports on the Business Ethics Review. Mr. Vieth and I attended that meeting, along with

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13/ See Fedders and Guttenplan, Document Retention and Destruction: Practical, Legal and Ethical Considerations, 56 Notre Dame Law. 5 (Oct. 1980).

Messrs. Matthews and Davis and the members of the Audit Committee. The Audit Committee presented its report to the Board, stated its conclusions, and proposed future preventive action by Southland, including implementation of the Code of Business Conduct that I had drafted. Mr. Matthews described the Business Ethics Review, discussing the subjects covered by the Legal Department's report.

Mr. Matthews then reported orally to the Board on the Mastropieri matter. He explained that while there were some suspicious circumstances, the Legal Department had been unable to determine that the fee was used for any illegal purpose. As a result, it had not been included in the report. His oral statement was accepted by the Board, which agreed with the disposition of the matter.

I addressed the Board on the scope, structure and methodology of the investigation. Mr. Vieth also addressed the Board and concurred in the Legal Department's conclusion, which had been reported by Mr. Matthews to the Board, that public disclosure of the report was not required.

XVI.

MY ROLE FOLLOWING THE BOARD OF DIRECTORS' MEETING

Between January 25, 1978 and February 21, 1978, I charged only five hours to this matter. Thereafter, I had nothing further to do with it until Arnold & Porter began

representing Southland and its officials in April 1980 in connection with the grand jury investigation of the Mastropieri fee conducted in the Eastern District of New York.

I did not, by the way, participate in any way in Southland's December 1978 underwritten public offering of $75,000,000 in sinking fund debentures. Arnold & Porter has not, to my knowledge, ever represented Southland in any underwritten public securities offering, and it did not represent Southland in this one. Neither I nor any other Arnold & Porter attorney participated in any way, therefore, in a decision about whether to disclose to Touche Ross & Co., Southland's independent public accountants, or to White & Case, the underwriters' counsel in the December 1978 offering, either (1) the Business Ethics Review report, or (2) the Mastropieri matter. I learned for the first time after April 1980, that the Business Ethics Review had been shown to Touche Ross & Co. and to White & Case in 1978.

XVII.

ALLEGATIONS IN THE INDICTMENT

There have, of course, been allegations made in the indictment returned against Southland and DeFalco on May 4, 1983, which describe events of which I had no knowledge -- and could have had no knowledge -- in 1977 and 1978. The indictment alleges an elaborate process whereby $20,000 of the Mastropieri fee was placed in a Canadian bank, allegedly "to be used as a slush fund from which a bribe was to be paid to an official or

officials of the Tax Commission." I had no knowledge of such alleged "laundering" of funds, and I had no way of discovering such actions, if they in fact occurred. (Indeed, according to the indictment, several of these actions occurred after the Business Ethics Review was completed.) Nor did I have any knowledge of other facts alleged in the indictment, such as the allegation that Mastropieri had agreed to "kick back a substantial portion" of his fee to DeFalco.

There were other allegations that I first heard when I testified before the grand jury on June 24, 1982. First, I was asked whether I had been informed of handwritten notes, in what appeared to be Mr. Matthews' writing, indicating that $40,000 of Mastropieri's fee might be "spread among members of the Tax Commission." I definitely had not been told of any such handwritten notes. Nor did I see any such notes until they were shown to me in the grand jury room on June 24, 1982. Although Mr. Matthews reported to the Board that the Legal Department had investigated the possibility of a bribe, there was no discussion suggestion or implying that $40,000 might be "spread among the members of the Tax Commission" at any of the meetings I attended. Second, I was never told by anyone that a member of the New York State Tax Commission had recommended that Southland retain Mastropieri. That proposition was first put to me by the prosecutor during my grand jury testimony, and I denied then -- and deny now -- ever having heard such a report from anyone other than the federal prosecutor.

The fact is that Southland was conducting an internal investigation in 1977 and 1978 with all the limitations that private parties have in performing such a task. It had no subpoena power and no ability to force individuals to tell the truth. I acknowledge that if Southland had then had the government's power to subpoena witnesses and to compel truthful testimony, further investigation might have uncovered additional relevant facts. It had no such power, and I was limited to the information provided to me by the Legal Department.

On the basis of the information provided to the Audit Committee, to Mr. Vieth and to me, a good faith and honest decision was made on the Mastropieri matter. I do not, of course, know all the evidence that the federal prosecutors have. If that evidence supports the allegations made in the indictment, obviously, there are substantially more grounds for suspicion than we, as private parties, had over five years ago.

XVIII.

PAYMENT OF MY LEGAL FEES

When I appeared before the House Subcommittee on September 8, 1982, I was asked about the legal fees being charged to me by Miller, Cassidy, Larroca & Lewin. I explained to the Subcommittee that there was a possibility that, in accordance with an established policy, Arnold & Porter would pay my legal fees because they result from services I performed while a partner in the firm.

After September 8, 1982, I embarked upon the process of obtaining the necessary written approvals from the Commission's Ethics Counsel and from the Office of Government Ethics for the payment of those fees. The appropriate government officials approved Arnold & Porter's payment of the fees, 14/ and the firm has paid my counsel through May 1983. Of course, payment of my legal fees by Arnold & Porter is not improper. Indeed, Arnold & Porter's policy is in keeping with standard indemnification for expenses incurred by partners, associates or other employees in the course of their duties. 15/

14/ See (1) my September 30, 1982, memorandum to Myrna Siegel, Ethics Counsel for the Commission; (2) the October 19, 1982, letter of David R. Kentoff of Arnold & Porter to me; (3) my October 22, 1982 memorandum to Ms. Siegel; (4) a November 8, 1982, memorandum from Ms. Siegel to me; (5) my December 13, 1982, letter to David R. Scott, Acting Director of the Office of Government Ethics, together with attachments; (6) a January 31, 1983 opinion letter from Mr. Scott to me; and (7) an April 18, 1983, memorandum from Ms. Siegel to me. The April 18, 1983 memorandum from Ms. Siegel informed me that the Office of Legal Counsel of the Department of Justice concurred in Mr. Scott's January 31, 1983 opinion to me.

15/ Another matter discussed during my September 8, 1982 appearance before the House Subcommittee concerns the disclosure form that I filled out when I began my service with the Division of Enforcement. My SEC Form 682, which concerns possible conflicts of interest, did not mention Southland because, there was in fact no "matter" involving Southland pending before the SEC on July 20, 1981, when I began with the SEC and filled out the form. My understanding of the SEC's regulations and the instructions to Form 682 has been confirmed by a written opinion from the SEC's Ethics Counsel, Myrna Siegel. Her June 21, 1982 letter is on file with the Subcommittee.

XIX.

CONCLUSION

My own review of the full history of the Southland Business Ethics Review and its investigation of the Mastropieri payment leaves me with the solid feeling that I carried out my responsibilities in it with the same personal qualities I seek to apply to all my professional endeavors. I approached that particular task with vigor, enthusiasm, and integrity. I applied to the evidence presented to me by the Legal Department the same balance of healthy skepticism, informed judgment and good faith I have been applying to legal problems ever since I proudly entered upon the practice of law. Anyone who doubts this simply does not know me.

If the allegations in the indictments are true, it now appears that some of the individuals interviewed by Southland's Legal Department lied. Had I known then what the prosecutor indicates he knows now, I would have recommended that the investigation continue. And had I then been satisfied that the allegations now made in the indictment were true, I would have urged that the Mastropieri payment be reported in the Business Ethics Review, or to appropriate authorities.

It is not hard to second-guess an investigation -- even one that is conducted by government officials who have subpoena power and the authority to prosecute for perjury. I cannot say, therefore, that Southland's investigation of the Mastropieri payment was perfect. I can say, however, that the fact that the

United States Attorney for the Eastern District of New York was able, after an arduous investigation of more than three years, to indict Southland and one of its employees, Eugene DeFalco, for conspiracy does not mean that everyone involved with Southland's own four-month investigation of this incident was corrupt or participated in a cover-up. For myself, I am sure of one thing -- every decision that I made during the Business Ethics Review was made honestly, with care and integrity.

I am surprised that at this late date -- three years and two months after the investigation was begun and after the grand jury has concluded its term by returning indictments against some "targets" but by refusing to return indictments against others -- the prosecutor still considers the investigation open and refuses finally to clear the names of those who played some role in the Business Ethics Review but who conducted themselves lawfully and properly.

I regret that action because I believe that it creates an unjustified cloud over the reputation of innocent people. When a matter has been as thoroughly investigated as this matter has been, and when a grand jury concludes such a thorough investigation with the indictment of some people and the exoneration of others, it is unfair to those who have gone through the process to continue such a probe indefinitely.

I hope that responsible authorities will bring this matter to a quick conclusion so that the public will be assured, as I know it will, that my own conduct was correct and lawful and that my testimony on all occasions was truthful.

That completes my prepared statement. I will be glad to answer any questions you may have on this subject.

Thank you.

Senator D'AMATO. Thank you, Mr. Fedders.

When did you first learn of the 1977 questionable payment of $96,500?

Mr. FEDDERS. I believe it was in early 1977, September of 1977. I learned it from my former partner, Bud Vieth.

Senator D'AMATO. You say you learned of that from your former partner. How did he give you that information? In what context did he explain it?

Mr. FEDDERS. At that time, Southland was conducting its business ethics review. I suppose, although I have no specific recollection, that from time to time Mr. Matthews would call Mr. Vieth and report on matters that required further inquiry.

SUSPICIOUS CIRCUMSTANCES WARRANT FURTHER INVESTIGATION

At that time, Arnold & Porter was housed in several buildings. I was in a different building than Mr. Vieth. He phoned me up one day, suggested I come to his office. I told him it was raining. He urged me still to come to his office. I went over to his office. And he told me about this matter and suggested it was one of the matters that required followup.

Senator D'AMATO. You talk about Mr. Matthews. What was his relationship to this entire matter.

Mr. FEDDERS. Mr. Matthews was then the general counsel of the Southland Corp. He is a man whom I have known since a few months after I joined Arnold & Porter in January 1973. I believe he is a man of high integrity and quality.

I thought he was approaching the business ethics review with vigor, great integrity, and a lot of healthy skepticism. He, as general counsel, was responsible for the day-to-day conduct of the investigation.

Senator D'AMATO. Is he still general counsel?

Mr. FEDDERS. I don't believe he is today. I believe he is now chief financial officer of the corporation.

Senator D'AMATO. Your testimony on page 26 indicates that Mr. Matthews said he reported the Mastropieri matter orally to the board, and explained that there were some suspicious circumstances, but that the legal department was unable to determine that the fee was used for illegal purposes.

Here we have got you conducting this outside investigation, constrained by Southland's desire to save money. You attend only one of 86 inquires while having knowlege of this $96,000 fee. Didn't he think it was suspicious? How many cases were pending?

Mr. FEDDERS. I think there were 40 cases pending.

Mr. Matthews certainly thought that the matter was suspicious, and he conducted an investigation into the Mastropieri matter. When we came to the time of the board meeting in January of 1978, it was a decision made not only by Mr. Matthews and Mr. Davis, as members of the legal staff, but it was joined in by the audit committee, by myself, and subsequently by Mr. Vieth, that there was insubstantial evidence, although suspicious circumstances, to conclude that any illegality had occurred here.

Senator D'AMATO. Again, going back to page 26 in your report where Mr. Matthews reports to the board that there was some question about the payments.

Don't you think that a general counsel would have an obligation to see why the fee was large, and didn't you testify to me that he also rejected some scheme for an airport lease of $20,000? What does that suggest?

Mr. FEDDERS. There is no question that those were suspicious circumstances that were among the items that I listed in my testimony as making the payment one that required further inquiry.

There was a request made that the legal fee be paid as an airplane lease. That was one of the four suspicious circumstances.

Senator D'AMATO. Were you made aware of that?

Mr. FEDDERS. I was. As was the audit committee. As was the board of directors.

Senator D'AMATO. Did you ever hear of any legal fee being submitted in a manner where the bill said, "Bill me for some airplane lease, $20,000, and the balance"? In other words, have you ever heard of anything like that before?

Mr. FEDDERS. I never heard of that before in my experience. I was comforted by the fact that Mr. Matthews said he rejected it out of hand. The legal service had been performed for several months. Some moneys were due and owing to Mr. Mastropieri. The fee was large. That was among the things that Mr. Matthews had to inquire into when he attempted to meet with and later spoke by telephone with Mr. Mastropieri, and Mr. Mastropieri assured him that that fee was to cover all the pending cases plus apeals.

Senator D'AMATO. Given circumstances, which I would think were rather unusual, wouldn't you think that prudence would dictate a complete and thorough breakdown of that legal bill? Did anyone ever ask for that?

Mr. FEDDERS. I don't believe the legal bill itself, the written statement, goes into substantial detail. Some lawyers bill with a lengthy statement; some lawyers just bill for professional services rendered. This is of the latter kind.

But Mr. Matthews, remember, he called Thomas Dougherty, the Long Island lawyer who had been involved in the cases for a number of years, who had no reason to be pleased that Mr. Mastropieri had been brought into the case. He inquired of him if Mr. Mastropieri was doing the cases.

Senator D'AMATO. Except that he was co-counsel. He was not pushed out altogether.

Mr. FEDDERS. He was not pushed out altogether. That is correct. He inquired of him. There was an investigation of this matter. It was a healthy investigation. I thought it was done with healthy skepticism. And then at the conclusion of the investigation, Mr. Matthews attempted to meet, but did speak by telephone with Mr. Mastropieri, as I told him.

And at least it was reported to me he followed the guidelines of inquiring to make his own determination that Mastropieri knows something about the substantive nature of the cases, telling him about the business ethics review, telling him why you have to make these tough inquiries. And Mr. Mastropieri gave an indignant response.

REASONS A THOROUGH INVESTIGATION CURTAILED

Senator D'AMATO. Did you feel comfortable in your role as outside counselor and adviser when, as a result of Southland's decision to save money, you were precluded from undertaking the kind of vigorous investigation that I submit was not undertaken here? Were you comfortable with the fact that you set out an outline for the company and for Mr. Matthews to follow?

Mr. FEDDERS. That's a fair characterization. Was I uncomfortable? No, not really. Southland was not the only company whose legal department conducted its own business ethics review. It was not the general practice. And certainly one can say without qualification that it is a more independent investigation when outside counsel conducts those investigations.

But I think it is fair that cost be a factor. Some of these questionable-payment investigations by corporations were $150,000, quarter of a million dollars, half a million dollars that it was reported, some extended all the way up to $3 million. For a corporation to be cost conscious I do not think is improper.

Now, I was called upon to lend my experience that I had gained over several years of conducting these investigations to talk about scope, structure, and methodology, to be available for consultation from time to time. But I cannot dispute with you that an investigation conducted by outside counsel is more independent than that conducted by inside counsel.

My role was simply to be available for consultation from time to time.

Senator D'AMATO. Let me read to you a quote, the following, from the 1982 opinion of the U.S. Court of Appeals, second circuit, relating to this case:

> We have independently reviewed the in camera submission of the grand jury materials and other evidence in the record. We have concluded without difficulty that there is probable cause to believe: one, the payment to the lawyer was part of a criminal scheme to bribe a public official or officials; two, a diligent investigation of the payment would not have provided the basis for deleting discussions of the payment to lawyer in the final Business Ethics Review or the reassurance given by the general counsel to accountant in February of 1978; and three, that the final Business Ethics Review was used to conceal the criminal scheme from the underwriter for the public offering and the accounting firm certifying the 1977 financial statements; and four, the Business Ethics Review investigation acts were taken in the name of the corporation to cover up the criminal schemes.

What is your response to those assertions that you either did not diligently investigate the alleged bribe or did not use good judgment in compiling your report and adequately disclosing your finding? This is the essence of this hearing.

Mr. FEDDERS. I have several responses, Mr. Chairman. First of all, I have not had the benefit, nor am I aware that counsel representing the individuals who are the targets, who are now the defendants in this matter, had any opportunity to review the in-camera submissions or do not know its quality, its integrity, or its composition.

I do not agree with the formulation of the second circuit in this paragraph that you refer to. But I add at least to your attention footnote 7 that accompanies that. There they are talking about probable cause. Probable cause does not mean conclusive proof.

Footnote 7 to that says:

> This is in no sense intended to suggest a probable, much less desirable, outcome either within the grand jury or upon further judicial proceedings, if any. It is to say only that there is direct evidence, not implausible on its face, specifically supporting a conclusion as to probable cause.

I simply do not know today how the second circuit could have reached those conclusions.

Senator D'AMATO. Do you still believe Mr. Matthews conducted a thorough, independent, thoughtful review as a prudent counsel would in this matter, given the $96,000 payment, given the fact that others had spoken to him, and given the existence of the questionable billing?

I would suggest to you that reasonable people could come to the conclusion that you were used.

Mr. FEDDERS. Well, Mr. Chairman, let me address Mr. Matthews there. I do not consider him a personal friend, but I certainly consider him a professional friend. I never visited him in his home, and I don't believe he has ever visited me at my home. So you understand some bit of the relationship.

Senator D'AMATO. I am not suggesting that.

Mr. FEDDERS. But I want to tell you about Mr. Matthews because, frankly, in my statement there are some circumstances that I have become aware of in my appearance before the grand jury that raises suspicions in my own mind.

I was told by the prosecutor that I was being shown Mr. Matthews' handwritten notes where there was a note in one of the corners about the question of some money being spread among the Tax Commission.

That raises questions in my own mind, but I can only tell you about Mr. Matthews. I worked with him within a few months after I joined Arnold & Porter in January 1973. So for quite a period of time before you come to this investigation in 1977, I found him candid, a quality lawyer, good experience, diligent, healthy skepticism, a man of integrity.

Sure, I have a question in my own mind about that statement. I am told by others there is an explanation for it. But it does not mean he is engaged in misconduct. Obviously, they are not going to tell me that information now, because I may have to go before a grand jury again and people are very careful about what they tell me. This is the state of my knowledge in this prepared statement in detail.

Do I think Mr. Matthews engaged in misconduct? No. I know the man. I respect him. I think there is an explanation for this. But I am going to be an attentive listener and watch very closely to see what happens in this investigation. There is a tenacious pursuit of truth going on. I am sure the prosecutor will get to the bottom of this. I look for its prompt conclusion.

But I am not here going to suggest to you that Mr. Matthews is a corrupt individual. With regard to the qualities of his investigation, I said before and I say again, an investigation of this kind can be conducted more independently by outside counsel. It has been in the past by other corporations conducted internally sometimes, but even with the assistance of an outside law firm or a man who had

the experience I had at the time, lending advice from time to time on scope, structure, and methodology.

But let's think about what Mr. Matthews would have done if this indeed was a corrupt payment. There are a lot of things he would not have told us. Would he have ever elevated it to Bud Vieth, my senior partner, when I was at Arnold & Porter and myself? Would it have been kicked to the audit committee and discussed in such a healthy forum on two occasions and eventually elevated to the board of directors? If this was a conspiracy, it was conducted with great quality.

But I don't believe it was. I think he's a man of integrity. The steps he followed I think were reasonable. Can you second guess it? You bet. You can second guess any investigation the Commission conducts, any independent investigation I conducted when in private practice. But I think under the circumstances at the time, based on the information I knew in January 1978, that the determination made by the audit committee, Messrs. Matthews and Davis, if I knew the full extent of their knowledge, was a reasonable conclusion at the time.

SURMISES, SUSPICIONS NOT CONSIDERED SERIOUS

Senator D'AMATO. What would it have taken for you to have recommended that the payments, the suspicious payments be included in the final report? What circumstances would have changed your thinking on that?

Mr. FEDDERS. One thing that would have certainly tipped the scale would be a direct allegation that this had been a bribe. Let's look at the four examples set forth on page 22 of what we knew at the time.

We knew it was a big fee. That is not a direct allegation that there had been a bribe.

Second, we knew there had been an unusual request for surreptitious billing. I can tell you that I never heard of that before, that method of billing in a legal fee, but I had enough experience in my legal career to know some people try to avoid taxes from time to time. That was a possibility that certainly occurred to me at that time. That did not mean there was a bribe to a judge or official.

Third, Mr. Kitchen's surmise that was disclosed in the interview to Mr. Davis and in his amended question, was simply a surmise, and that was put to rest by interviews of other people.

Senator D'AMATO. Surmised what?

Mr. FEDDERS. Surmised something improper had taken place.

Senator D'AMATO. Who was Mr. Kitchen?

Mr. FEDDERS. Mr. Kitchen was Mr. De Falco's superior with regard to the northeastern 7-Eleven stores. That surmise was not a direct allegation of impropriety. He said he surmised from conversations. When I first heard that, the first thing that occurrred to me is that there was going to be fancy entertainment. Those kinds of things were discussed.

The fourth thing is Mr. Pender's suspicion as reflected in his response to a questionnaire. That again, was only suspicion and no direct allegation.

Senator D'AMATO. Who was Mr. Pender?

Mr. FEDDERS. Mr. Pender, who was the controller of the corporation.

Now those four factors taken any one of them——

Senator D'AMATO. John, let me interrupt you right at this point. Were you involved in the questioning of any of these gentlemen directly?

Mr. FEDDERS. Only—I participated in January 1978, when the Audit Committee met with Mr. Davis and Mr. Matthews to hear about the investigation, to sort of wrap it up. Mr. Dole, who is the person to whom De Falco reported in the pyramidal scheme, that Mr. Dole was called into that meeting twice. As I said in my testimony, one of the two audit committee persons present questioned him quite hard. This was a meeting, as I recall from my notes, went from about 9 or 10 in the morning to the afternoon. He was pressed vigorously. So, in that sense, I participated in that interview along with the Audit Committee.

Senator D'AMATO. You didn't have an opportunity to press Kitchen or the other individual you mentioned?

Mr. FEDDERS. I did not.

Senator D'AMATO. Go ahead.

Mr. FEDDERS. So if you look at these four items on page 22, none of them is a direct allegation of a bribe. They are surmises, suspicions and suspicious circumstances. I tell you without question, this was a suspicious matter. It was investigated, but once we had made our conclusion, no one said, "Well, let's stop there, and let's bury it." It was taken first to the audit committee and then it was taken to the full board of directors. And I felt good about that at the time. It was good that we were not just going in there with a written report. The whole board was going to hear about this.

Now I can't tell you, because my recollection does not provide it, the full details of what was said at that January board of directors meeting, but I am told my former partner, Bud Vieth, who accompanied me to that meeting has a very clear recollection and has so testified as to what was taking place. And the board was given a full presentation. I don't recall. I know it was discussed, but it just happens to be an event that I can't lay the A to Z out for you.

Senator D'AMATO. Was the Comptroller part of that board of directors?

Mr. FEDDERS. I don't believe that the controller, Mr. Pender, was a member of the board of directors.

Senator D'AMATO. You mean you don't know what questions Mr. Mathews asked or didn't ask him with regard to why he was suspicious?

Mr. FEDDERS. I've got to tell this, that I would have told you that I was certain that Mr. Pender had been interviewed. In the grand jury room, I was asked the question, "Would you be surprised to learn that Mr. Pender had not been interviewed during the investigation?" And my response, I can't quote it, but it was something to the effect, "you bet." So that raises a suspicion in mind today, if a prosecutor asked me that, was Mr. Pender, in fact, interviewed. I can't tell you he was interviewed. I don't know the dialogue that took place. Now I have got a suspicion in my own mind as to whether he was interviewed, because the prosecutor asked that question.

Consequently, if you want to know, would I be surprised if I knew Mr. Pender wasn't interviewed, the answer is, "you bet."

Senator D'AMATO. So is it reasonable to conclude, as a result of what you have just said, that you assumed that he was interviewed and was asked the appropriate questions as to why he was suspicious?

Mr. FEDDERS. Yes, sir.

SOUTHLAND SEEKS OUTSIDE COUNSEL

Senator D'AMATO. Why did Southland come to you—for what reasons did they hire you and why—did they look to have an outside consultant or counsel brought in for the investigation known as the business ethics review?

Mr. FEDDERS. Southland, as a client of Arnold & Porter, predates me by some considerable time. Southland is a long-time client of Arnold & Porter. The relationship extends, I'm sure, back into the origins of Arnold & Porter. Bud Vieth, who was a senior partner and managing partner at Arnold & Porter, was the partner in charge of that account. I would, from time to time, be called in on that matter for Southland, as for any client.

Senator D'AMATO. Let me stop you at this point.

Why would Southland have brought in the firm at this point? Is there any particular reason to conduct this review?

Mr. FEDDERS. I know it speaks a bit of me personally. Apparently, they know I have some knowledge about the conduct of internal investigations. I don't believe I had published yet on the subject at that time, but I had certainly spoken publicly.

Senator D'AMATO. Was this a regular investigation? Did they have a practice every year, every 3 years, every 2 years, of holding an internal investigation?

The point of my question is, What unusual event, if any, would have precipitated this review?

Mr. FEDDERS. Sometime prior to November 9, 1976, an SEC staff member called a member of the Southland legal department, it could have been Mr. Matthews, and made an inquiry about the conduct of a questionable payment investigation. Mr. Matthews asked that the inquiry and the request be put in a letter. That was a letter dated November 9, 1976, which arrived at Southland sometime about mid-November 1976. That letter, when received by Southland, was transmitted to a person who then worked for me at Arnold & Porter, by the name of Jane Snyder. She provided that letter to me. Subsequently, I had conversations with Messrs. Matthews and Davis about the SEC's request of the investigation, both with regard to the scope of the request and the timing. The Commission wanted a response in writing by December 22, wanted a meeting on Christmas eve of 1976.

We then had meetings with the SEC staff extending over several months, with regard to whether or not they had any suspicions in mind. And eventually, Southland agreed——

Senator D'AMATO. What did they say about whether they had suspicions in mind?

Mr. FEDDERS. At first they said nothing. They said they did not have any suspicions. There was a meeting at the Commission's

office which was very unsatisfactory, from my point of view, where there was continual insistence that the SEC staff knew absolutely nothing about impropriety. At some later time a branch chief showed up at the meeting. He heard the staff making that statement that they had no information. He called a total halt to the meeting. He called his staff out, then came back and apologized and said that there were some suspicions about some payments in the Midwest. And Southland agreed to promptly conduct an inquiry with regard to that.

That is set forth in full. The total story that I'm addressing there is set forth in full in Southland's Business Ethics Review, a copy of which has been made available to your counsel.

SHOULD INTERNAL INVESTIGATIONS BE MADE PUBLIC

Senator D'AMATO. In your dealings on other business ethics reviews, have you ever advised that information about questionable payments be disclosed to the SEC and/or the shareholders, and if so, will you describe them and compare them to the Southland matter?

Mr. FEDDERS. I have advised corporations, numerous corporations, that the conclusions of the investigation, the information obtained, may or may not be material nonpublic information. Some corporations said they simply did not want to put up with any challenge from the Commission and did not care whether it was material or not, and they were prepared to disclose the information. There were other corporations who had some questionable activity, where determinations were made by them that there would be no disclosure, and I was asked whether I concurred in that judgment or not.

I had a practice at the time, which was followed here in the Southland case, that I would never render a written legal opinion with regard to materiality of the events of a questionable payment circumstance, unless I participated in that investigation by conducting the investigation. Indeed, as we concluded the Southland questionable payment investigation, I was asked for a written legal opinion by either Mr. Davis or Mr. Matthews with regard to the materiality of the conclusions in the Business Ethics Review. I told them I would not render what I would call an "assumed fact" opinion, but that I would be prepared to counsel with them with regard with what was going on at the time. I certainly discussed with Mr. Matthews the May 1976 report of the Commission to the Senate Banking Committee with regard to questionable payments.

The day after that report was issued, the most significant decision with regard to materiality, the *TSCV* v. *Northway* decision, was handed down by the Supreme Court. I am sure I discussed that. I discussed with them the speeches of Chairman Ray Garrett, Commissioner Al Sommer and Commissioner Phil Loomis. I concluded by telling them the determination they were making, that this was not material, that what was in their report was a reasonable conclusion. *sion.*

Senator D'AMATO. At the time of your investigation, did you ever consider whether or not the business ethics review would be given to the accounting firm and underwriters?

Mr. FEDDERS. I was never consulted, as I recall, specifically with regard to the providing of the report to Touche Ross or counsel for the underwriters. There may have been generic discussions about what use could be made of the report after January 1978. If you gave it to this party or if you gave it to that party, would it be a waiver of the attorney-client privilege. I probably had generic discussion, but I was not consulted. And as I said in my testimony, I did not learn until after April 1980, that the business ethics review report had, in fact, been provided to Touche Ross or to White & Case. I wasn't consulted on that. I believe I subsequently learned that Southland made that determination to provide it, together with the judgment of their tax counsel, but I was not included in that determination, although I may have had generic discussions of how attorney-client privilege may be waived.

Senator D'AMATO. What would your thoughts have been had you been advised?

Mr. FEDDERS. I had formulated for other clients some techniques by which you could avoid waiver of the attorney-client privilege with regard to a Business Ethic Review report, that you did not want the attorney-client privilege waived. What could occur, is that you could meet with underwriter's counsel, or you could meet with counsel for Touche Ross or Touche Ross themselves, and give them a legal opinion that what is in the report does not constitute material nonpublic information, does not require disclosure in the context in which they inquired.

So, therefore, you have a legal opinion, where the privilege is not applicable, because it is being given to someone outside the scope of the attorney-client privilege, but there is no waiver of the underlying document; namely, the questionable payment report of the business ethics review. That technique could have been applied here, but I was not asked about that technique.

DESTRUCTION OF EXTRA DRAFTS AND COPIES

Senator D'AMATO. Let me turn to the memo dated January 27, 1978.

Mr. FEDDERS. These are handwritten notes?

Senator D'AMATO. Yes. If you want to take a look at it, it is on page 000234 in the notebook of documents.

Mr. FEDDERS. OK.

Senator D'AMATO. That's a memo from yourself to Bud Vieth and Peter Blekely regarding the Southland Corp.'s business ethics review.

You instruct them as soon as possible to send you all drafts or final copies, (1) of the legal department's report to the audit committee, and (2) the audit committee's letter to the board, since you intended to retain only one copy of the report and letter and intended to destroy all the other copies and drafts.

Would you explain why you wished to destroy these documents?

Mr. FEDDERS. Both of these gentlemen are older than me so I didn't instruct them. I requested them. I think the memorandum said, why did we do this?

I think it's a terrible practice for a lawyer to save drafts when an investigation is concluded. Let me give you several examples, take it outside of this context room. Then let's come to this context.

If you draft a letter to someone and you have drafts, why save the drafts? Let the final letter speak for itself.

Mr. Chairman, as you prepared for today's hearing, you may have gone through several drafts of your opening statement, why save the drafts?

Let me tell you a practice that I believe is wholesome at the Securities and Exchange Commission. As we prepare to file suit against X,Y, Z corporation we prepare drafts of a complaint. It's reviewed by senior people, it eventually goes to an associate director, and frequently to myself, drafts of complaint. Commas are changed, whole substantive areas are changed, why save the drafts?

Because they can be discoverable under a Freedom of Information Act request. Probably questions are raised with regard to the scope of the conduct, et cetera.

Let your last product speak for itself.

That generally can be applied. If there is a legal duty to retain documents, you never destroy documents.

I have written an extensive piece with regard to the retention and destruction of documents which appears in the November of 19—some year—1977, 1978, Notre Dame Law Review. I've thought a lot about this; I understand the provisions of 18 U.S.C. 1503, 1505 and 1510 with regard to obstructions and destruction of documents.

In this context, why save the draft, why save the drafts of a letter to the audit committee?

Senator D'AMATO. Would it be fair to characterize yourself as an authority in this area having written on it?

I just gave you a softball, you'd better hit it. [Laughter.]

Continue. I'm not going to give you too many more.

Mr. FEDDERS. I don't think there's too many softballs here today.

Senator D'AMATO. That one was. I have to be impressed by the fact that you wrote for the Notre Dame Law Review in 1977.

Mr. FEDDERS. October 1980.

Senator D'AMATO. Let me ask you this: You stated that you intend to retain only one copy of the report and letter and to destroy all other copies and drafts.

Have you ever done that before?

Mr. FEDDERS. Yes, sir.

Senator D'AMATO. Have you done it repeatedly before in areas such as this?

Mr. FEDDERS. When you say repeatedly——

Senator D'AMATO. Is this your general practice?

Mr. FEDDERS. It's a wholesome and sound general policy and practice.

Senator D'AMATO. You apply it then?

Mr. FEDDERS. That's correct. Some corporations at the time of conclusion of investigations when drafts are still circulating might be under grand jury inquiry. At that time a determination might have to be made whether that would be an obstruction of justice.

Senator D'AMATO. Putting aside whether there's a grand jury investigation——

Mr. FEDDERS. If there's no legal duty to retain documents and drafts, I believe this to be a sound practice which I follow in substantially all circumstances.

Sometimes clients say let's keep a history file of drafts that are being prepared.

Senator D'AMATO. Your request is regularly of the same nature and that is what you're testifying to this committee?

Mr. FEDDERS. I would so testify and I confirm that for you, Senator.

Senator D'AMATO. Your response is rather important; It's a key element because if you do indeed have such a practice, the exception being where documents are subpenaed or may be the subject of a grand jury investigation and you send a letter which says "I intend to retain only one copy of the report and letter and to destroy all other copies and drafts," then an inference of impropriety would not automatically arise.

Mr. FEDDERS. I'm not in deep trouble.

Senator D'AMATO. That's why I say it's important. Would you be in a position, if I give you some time, to submit to this committee other instances where you have used this practice?

Mr. FEDDERS. I'd certainly be glad to, but they would probably contain the names of other corporations and they may not want——

Senator D'AMATO. You could for the purposes of this committee expunge them or we could expunge them.

Obviously you may have to speak to your former clients in connection with that, and we would, of course would take the necessary action to protect the documents. Again, we would only be talking about a form that you have used this as a rather consistent practice in matters of this type.

Mr. FEDDERS. I would clarify it only in this extent, Mr. Chairman. I can't tell you that you're going to find a lot of memorandums.

Senator D'AMATO. We don't need a lot. I want to see——

Mr. FEDDERS. Remember, I said these two chaps were older than me. Mr. Vieth is probably a pretty old guy; he's in his fifties or sixties.

Senator D'AMATO. Wait a second. [Laughter.]

Mr. FEDDERS. Mr. Bleakely is only a few years older than me. I treat people senior to me politely, I write them memos and ask them to do things like this. If it was the case where I was a senior partner on this, I would probably have just said to the associates on the matter: "Bring all the drafts in, give them to Alyce my secretary, make sure they're all destroyed."

So I can't, as you're asking this question, I can't recall a single circumstance, where a memo like this exists.

It's my practice. That I can assure you. I have written about that. It's a sound practice; it's one that I think members of the bar would generally agree to.

Let me tell you where there's a dichotomy regarding the savings of documents that occur. Today when you do underwritten public offerings you come out with a final prospectus and a registration statement.

Some lawyers will tell you, and they will swear by the rule, that you should save every draft from the first draft you do of the registration statement all the way to the final, so that you have the history or indeed the histrionics of the development of the prospectus.

Other lawyers will cast great aspersions on that notion and say, "Absolutely not. Why get tied down in litigation if litigation comes about in what you said in all the drafts? Let the last document speak for itself."

There's a substantial disagreement, particularly with regard to registration statements, as to whether you save drafts or not.

My practice with regard to certainly things of this nature—I don't save drafts of every letter I draft—my secretary knows I go through a number of drafts. When we do complaints, I tell the staff, "Destroy all the drafts."

Do people destroy all the drafts all the time? Probably not. People like to squirrel documents away.

MASTROPIERI DOCUMENTS KEPT SAFE BUT NOT MENTIONED IN REVIEW

Senator D'AMATO. On page 000127, would you turn to that? There is a quotation which reads "New York documents, separate safe vault."

Would you first explain that notation and second, if indeed the documents were important enough to place in a vault, why weren't the questionable payments that they relate to mentioned in the business ethics review?

Mr. FEDDERS. These I believe are the handwritten notes of Mr. Michael Davis. They purport to record a phone conversation he had with me on January 13, 1978. I reviewed this in preparation for this hearing as I reviewed everything in the book.

I don't dispute anything that's in this memorandum. I do recall generally, not on this date, discussing disclosure, destruction of drafts, the New York situation with him and the fluid milk situation, which is discussed at the bottom.

I don't recall specifically telling him to put the Mastropieri or the New York documents in a sensitive, safe place. But that would have been similar to what I said.

I would have said, "Look, if the investigation is over, we're going to keep copies of the report, we'll have a copy and you'll have a copy. With regard to notes, memorandums, and corporate documents that you prepared during the course of the investigation, put those in a safe place."

This Mastropieri matter, as I said before, was frankly suspicious. Although I don't recall it, it's not unlike me to say "take the Mastropiere documents and put them in a safe place."

The only hesitation I say in confirming that with capital letters is I can't recall any Mastropieri documents.

Senator D'AMATO. Did you ever see any of the Mastropieri documents?

Mr. FEDDERS. My lawyer, Mr. Lewin, asked me that the other day, did I see any documents?

As I said to him, maybe somebody at one of the meetings brought the check and waved the check. I don't recall ever seeing the amended questionnaire.

I don't ever recall—I know I did not see any handwritten notes of interviews, so although I don't doubt Mr. Davis' notes, I don't know what I would have been talking about at the time.

Senator D'AMATO. Do you still want to say that as an experienced counsel with a strong background, reasked the kinds of questions that you would expect as to why he had suspicion? This doesn't sound to me like a man who exercised diligence. If you were going to undertake a review ordered by the SEC, which was agreed to by the company, why wouldn't you talk to the controller? I would think you would especially want to question him, given the fact that he was suspicious.

Mr. FEDDERS. Mr. Chairman, let me clarify a couple of things. I'm sure Mr. Matthews and Mr. Davis during this period of time reported to me the substance of interviews, not just Mr. Mastropieri's.

I don't think they called me following every interview they conducted and would report to me, "Here's what he said and here's a blow-by-blow dialog."

In the universe of the entire investigation between September and the time it was signed off in January, I was reported the substance of a number of interviews. I think I was told about Mr. Thompson's; I think I was told about Mr. Dole's; I was told about Mr. De Falco's; I was told about Mr. Mastropieri's.

If you ask me I would say, "I thought I was told about a Mr. Pender interview." The prosecutor threw me a curve. He said, "Would you be surprised if Mr. Pender was not interviewed?" And I said, "You bet." Or something to that ilk.

I would be surprised, but at the same time I don't recall specifically every detail that was provided to me.

Senator D'AMATO. I understand. Southland was indicted, right?

Mr. FEDDERS. For the acts of one of the employees, alleged acts of one of their employees.

Senator D'AMATO. Look, I understand the strengths and the weaknesses of the grand jury system. I'm certainly not here to taint anybody's reputation but these things must be dealt with, you have requested this, we owe it to the public, we owe it to this committee, and we owe it to you, and ourselves to get these questions out.

SOUTHLAND HIDES INCOMPLETE INVESTIGATION

We've only spent maybe 20 or 30 hours, the staff and myself, going over these reports, and documents. You know, however, it appears that there is someone or a group of people over at Southland who used you. They wanted a man of great integrity or a firm of great integrity to come in here and to report that which they had disclosed while they withheld other pertinent information. Their motive was to create an aura of integrity.

I can't believe otherwise.

You know, I don't think that that was by accident. You have testified you were an expert in the business ethics reporting area. It appears what happened here is that there was an incomplete investigation conducted. It appears that Mastropieri was interviewed at

the most over the telephone, unlike the other employees or consultants.

Here's a guy they paid $96,000 and they interviewed him over the phone. Thus, the explanations given to the audit committee and the board were also faulty and incomplete.

I would suggest to you that people did not want that committee to suspect any wrongdoing, and the idea of saying we're going to hold down our cost, was an excuse to restrain the investigation. The idea that 87 interviews took place and you were brought in on one is disturbing. The question does a young lawyer directed by senior partners, question the process?

Are you supposed to question and say: "Well, senior partner, we had better conduct more of these interviews ourselves or step away from this thing, because I don't like this thing?"

You meet men of character and integrity in the corporate structure. I don't know what young lawyer would say to them. Could he say: "Wait a minute, I want to interview this guy and we have to do it ourselves."

Obviously you put faith in the fact that you were dealing with people who called you and your firm in. The fact is that they can use people of great character and ability in this manner. Then you've got this great problem of digging out thereafter and setting the record straight.

I would suggest to you that there were those, and of course the grand jury agrees since they voted an indictment.

What business relationships did you have with Southland thereafter? Did you represent them or do work for them subsequently?

Mr. FEDDERS. I'm sure I did, Senator. They are a longtime client of Arnold & Porter. With regard to the business ethics review, as I said in my testimony, after early February 1978, I did not have anything to do with it or any followup until April 1980, when a prosecutor called, Mr. Harmon of the U.S. strike force in the eastern district of New York, called Southland and informed them there was a grand jury investigation.

This was a few days after Mr. Mastropieri was indicted for another course of conduct.

During the period from February 1978 through April 1980, I am certain I worked on other matters for the Southland Corp. Your statement with regard to my being used is your own view.

I will not dispute your view.

Senator D'AMATO. I suggest that your firm was used, and that Southland didn't care about you.

How many hours did you finally bill them for? What was the total fee in connection with your law firm?

Mr. FEDDERS. I don't know, Senator. That I have not checked.

Senator D'AMATO. Can we get that information?

Mr. FEDDERS. I would ask Arnold & Porter if they would provide it. I don't have it within the scope of my reach.

[The information follows:]

LAW OFFICES
MILLER, CASSIDY, LARROCA & LEWIN
2555 M STREET, N. W. SUITE 500
WASHINGTON, D. C. 20037

HERBERT J. MILLER, JR.
JOHN JOSEPH CASSIDY
RAYMOND G. LARROCA
NATHAN LEWIN
MARTIN D. MINSKER
WILLIAM H. JEFFRESS, JR.
R. STAN MORTENSON
THOMAS B. CARR
JAMIE S. GORELICK
JAMES E. ROCAP, III
STEPHEN L. NIGHTINGALE
SETH P. WAXMAN
DAVID O. STEWART
JONATHAN B. SALLET
ANNE SHERE WALLWORK
RANDALL J. TURK
STEPHEN L. BRAGA
JOHN F. SAVARESE

COURTNEY A. EVANS
OF COUNSEL

TELEPHONE
(202) 293-6400

TELECOPIER
(202) 293-1827

TELEX
89-2340

September 16, 1983

Senator Alfonse M. D'Amato
Chairman, Subcommittee on Securities
Committee on Banking, Housing and Urban Affairs
United States Senate
Washington, D.C. 20515

Dear Senator D'Amato:

At the close of John M. Fedders' testimony during the June 23, 1983, hearing before the Subcommittee on Securities, you requested that Mr. Fedders produce for the Subcommittee other memoranda requesting return or destruction of drafts of documents similar to the Southland Corporation's Business Ethics Review.

As Mr. Fedders explained at the hearing, it has been his customary practice not to retain drafts of such documents unless there is a legal duty to retain them. The memorandum dated January 27, 1978, which was provided to the Subcommittee was the only written memorialization of this practice that Mr. Fedders can recall from the various internal corporate investigations in which he was involved. The Southland review involved two attorneys at Arnold & Porter who were senior to Mr. Fedders. Accordingly, he requested return of drafts of the Business Ethics Review and of the Audit Committee's report in a written memorandum as a matter of courtesy. In other investigations, Mr. Fedders was the senior attorney and he effectuated his practice through oral, not written, directions.

I am sorry that this response to your request has been delayed, but I have been out of the country for an extended period. If you have any further requests of Mr. Fedders, please let me know. Otherwise, I will assume that the Subcommittee's review of this matter is concluded.

Sincerely yours,

Nathan Lewin

NL/clb

Senator D'AMATO. Do you recall how many hours you put in on this entire matter?

Mr. FEDDERS. I'd have to add up the various months. Let's think about it. In April, May, I spent limited time, June, July, I recall from my notes I spent only 2 hours, August, I spent zero hours, September, and October, and November were extremely light.

Senator D'AMATO. Lets go over those hours again and examine my theory.

I admit to you that it is only a theory. I think you were brought in as a cover. A good cover.

Mr. FEDDERS. I have a list someplace, Senator, that we are searching for, of my hours during the various months.

Senator D'AMATO. Some months you put no hours in at all?

Mr. FEDDERS. There is a very good reason for that.

Senator D'AMATO. I am not finding fault with you. I am just——

Mr. FEDDERS. The reason why I did not work in July and August is very personal.

Senator D'AMATO. I am not finding fault with you.

Mr. FEDDERS. Here it is. During the period prior to June 1977, I don't know that Arnold & Porter had an account called the Southland business ethics review. From June 22 till the end of the month of June, my records show that I billed 3¼ hours.

During July 1977, my records show that I billed only 2 hours. I probably did not work but a day or two during the month of July.

During the month of August, my time records show that I billed zero hours.

During the month of September 1977, I billed 8 hours.

During the month of October 1977, I billed 14 hours.

During the month of November, 6½ hours.

Now you get into the rainy season in this matter, and during the month of December 1977, I billed 99½ hours.

During the month of January 1978, I billed 88¾ hours.

During the month of February through—February 1 through February 21, I billed 3¾ hours.

And thereafter I billed no further time to the business ethics review until April of 1980, when the grand jury investigation commenced.

SEC INVOLVEMENT WITH SOUTHLAND

Senator D'AMATO. OK. Let's go over the chronology of SEC events relating to this matter.

What has the involvement of the SEC in this case been to date?

Mr. FEDDERS. Are you talking, Senator, about during the course of the BER, or are you talking about the Commission's conduct since I have joined the Commission?

Senator D'AMATO. Both, from the beginning, right up until you joined the Commission.

Mr. FEDDERS. OK. Sometime prior to November 1976, probably in the latter part of 1976, the general counsel of Southland, Mr. Matthews, received a call from the staff of the SEC. That was following up on some subpenas that had been served on Southland in connection with other investigations that were being conducted. And the

call in there, there was a request for Southland to conduct some sort of inquiry.

Mr. Matthews asked that the request be put in writing, and on November 15, Mr. Matthews received from the SEC's Division of Enforcement a November 9 letter that requested that the company furnish the SEC staff by December 22 a written report summarizing all relevant, illegal, or questionable transactions from the period January 1, 1969 to the then present time.

The letter also requested a meeting at the Commission's offices on Christmas eve 1976. The general counsel provided, as I said earlier, Jane Snyder of Arnold & Porter a copy of that letter. She gave it to me, and I then proceeded to have some conversations with Mr. Matthews and Mr. Davis.

Senator D'AMATO. No wonder why they sent a young man in the firm there—it was Christmas Eve.

Go ahead.

Mr. FEDDERS. This late in the afternoon I don't feel so young, Senator.

Senator D'AMATO. Continue please.

Mr. FEDDERS. On November 30 and again on December 1, we had telephone conversations with staff members of the SEC's Division of Enforcement, asking them whether they had any knowledge of questionable payments made or received by the company. They said they did not.

On December 7, 1976, the general counsel and I met with three attorneys from the SEC's Division of Enforcement, including a branch chief, to discuss the November 9 letter.

At the outset of that meeting, the general counsel described to the SEC staff the company's response to earlier SEC subpenas regarding investigations of other companies in the brewing industry, the company's response to an IRS 11 question questionnaire, company structure, and then there followed a general discussion of the Commission's request.

Senator D'AMATO. What was the nature of your involvement and the SEC's involvement in this matter after you began work there?

Mr. FEDDERS. Two statements on that, Senator.

After the conclusion of the business ethics review in January 1978, there was no communication with the Securities and Exchange Commission. I learned subsequently that the Commission's inquiry had ceased by reason of this fact.

At some time the Dow Jones Co. made a comprehensive Freedom of Information Act request of the Securities and Exchange Commission with regard to all companies involved in questionable payment activities.

As a part of providing the Dow Jones Co. responses thereto, a Mitchell Dembin of the SEC staff called me on one day and he said the SEC's documents with regard to Southland were being turned over to Dow Jones and wanted to know if I wanted an opportunity to review those documents. I told him I did.

Now, having some experience in this area, I know the Commission does not respond to an FOIA question unless an investigation is concluded.

I told Mr. Dembin I wanted to see them. I reviewed the documents, told them the company had no objection—after consulting

with the company's officials. The documents were released, and were noted in the SEC's news digest. To make certain the SEC was releasing only what they told me they were releasing, I made a similar request for the documents at that time.

Senator D'AMATO. That was in 1978?

Mr. FEDDERS. I can't tell you—no, no, Mr. Chairman, I think that probably was either 1979, 1980.

Senator D'AMATO. That is how it came about?

Mr. FEDDERS. That is how I knew in my mind that there was no ongoing SEC investigation.

When I joined the Commission staff, I was required to complete a conflict-of-interest statement.

POSSIBLE CONFLICT OF INTEREST

Now when you leave Arnold & Porter, you are not left to your own design to complete that statement; you are provided the assistance of a Government ethics committee and a person at the firm circulated to the appropriate partners and associates, asking them if they knew of any investigation being conducted by the Commission in which Arnold & Porter was representing individuals or persons—either witnesses, targets, subjects—although those terms aren't used at the Commission.

That memoranda was circulated. A response, together with my own thinking of the problem, and my response was made.

Southland was not included on that, because to my knowledge the Commission was not investigating Southland. I know now, as a matter of fact, Southland was not being investigated by the Commission at that time. So my statement was complete.

Now, when the House subcommittee raised a number of questions with regard to the adequacy of that report in June through September of last year——

Senator D'AMATO. All prospective SEC staff members are required to fill out SEC form 682, which is what you are referring to.

Question 6 on the form asks whether the person is or has been "involved either as a party or a witness in matters within the jurisdiction of the SEC." That is question 6.

Question 7 on the form asks for the description of any matters that "might conflict or give the appearance of a conflict of interest with the duties and responsibilities of the SEC."

With respect to question 6 of form 682, why did you not consider the activities of Southland to be a matter within the jurisdiction of the SEC?

Further, do you believe that Southland has engaged in any wrongdoing that is the subject to disclosure under the securities law which the SEC administers? Finally, did you have reason to believe at that time that they had engaged in any wrongdoing?

Mr. FEDDERS. There are a number of questions there, Senator. Let me try to answer them as I recall them.

First of all, footnote 15 on page 30 of my prepared statement addresses this in part. When I joined the Commission, I was very cognizant of the importance of those questions.

The key word throughout each of those questions is the word "matter," as to whether it is a "matter" pending, involving or pending before the Commission.

Southland was not such a matter. My response did not include that.

In June through September, when the House subcommittee staff raised questions with regard to why Southland was not on there, I went to Myrna Siegel, the ethics counsel at the Commission, and asked her whether my understanding of the form was complete.

She gave me a written opinion to that effect, which is dated June 21, 1982, and that has been provided to this subcommittee as well as to the House subcommittee. So I have no question that my conduct at that time was correct.

Now you have asked a further question that is not within the scope of the form, and that is whether Southland at that time had a disclosure obligation that I was aware it was not fulfilling.

That is a very complex question. I can tell you what I have said before the House subcommittee, and I believe you have a copy of the transcript of the executive session when I testified before it in September of 1982. Remember, beginning in April 1980 until I left Arnold & Porter in July of 1981, I worked as defense counsel representing Southland and officials in the questionable—in a grand jury investigation.

At that time and when I testified in September and as of today, I have no ability to demonstrate that Southland engaged in bribery in its course of conduct. Mr. Harmon, the prosecutor, has been tenacious in the investigation. He knows things of which I am not aware. Consequently, I am not in a position today to say that the Mastropieri—not today, but more principally in September. Today there has been an indictment, and I have to assume that the Government operates——

Senator D'Amato.

So this is the breath of your knowledge with regard to the Southland matter?

Mr. FEDDERS. That's right. My statement here speaks fully of the conduct of the Business Ethics Review and my representation of the company and individuals in the grand jury investigation.

Sure, there were some contradictory statements, more suspicions and other things came about. But I am talking about, "Did I have the ability to prove that there had been this misconduct?" And the answer there is no.

Senator D'AMATO. When did you first disclose your involvement in regard to the Southland matter to the SEC? Did there come a time that you did?

Mr. FEDDERS. Yes; there was.

Senator D'AMATO. Would you tell us when that was and what brought that about?

Mr. FEDDERS. March 23, 1982, was the rendering of the decision of the U.S. Court of Appeals for the Second Circuit in the decision called "In re John Doe." We all know that to be Southland now. I don't believe I learned of that decision until late March of 1982. It couldn't be much after the 23d, but it was still in March.

In early April, in mid-April, the decision was discussed—not the name Southland—in staff meetings with the SEC's Division of En-

forcement. Indeed, as you enter April, the decision was discussed in other public forums in which I was active, although I did not participate in the discussion of the case itself.

About April 15 to 19th I had a telephone conversation with Mr. Bleakely, my former partner, who told me that based on the decision of the second circuit, Mr. Harmon wanted to interview me, not before the grand jury but simply to interview me.

Then on April 20, 1982, I was contacted by Mr. Harmon about the possible interview. It was sometime about that time to early May that I first informed Chairman Shad, Daniel Goelzer the then general counsel, and Myrna Siegel, the ethics counsel, that I would be interviewed by Mr. Harmon about the John Doe matter. All were not told at the same meeting.

The first question the chairman asked me is, "Who is John Doe?" I told him I could not tell him. In fact, when I testified as late as September 1982 before the House of Representatives in the executive session, not a single question came to me as to who John Doe was. Southland was never mentioned. So it was about April 23, early May, that I told the Commission of my involvement.

Senator D'AMATO. At what point did the SEC initiate their own investigations of this matter?

Mr. FEDDERS. I do not know. All I can tell you is that I had investigative testimony taken from me for over four hours by the person conducting that investigation, Michael Wolensky, the regional administrator of the Commission's Atlanta regional office. That investigation must proceed as if I do not exist. I have no role in that investigation at the Commission.

Sure, I have been interviewed under oath for over four hours. I don't know when the investigation commenced. I don't know its status today.

Senator D'AMATO. So in terms of the investigation, it is fair to say that your only dealings with them was as a witness and for no other purpose?

Mr. FEDDERS. That is correct.

Senator D'AMATO. And you have no knowledge other than the fact that an investigation is underway? Could you give this committee any information in regard to the status is of the investigation?

Mr. FEDDERS. I could not.

Senator D'AMATO. OK.

Mr. FEDDERS. And that's proper that I stay out of it, and I intend to.

MATTERS INVOLVING SOUTHLAND OR ARNOLD & PORTER

Senator D'AMATO. To what extent, have you participated in matters involving Southland since your arrival at the Commission, in June of 1981?

Mr. FEDDERS. None whatsoever, again except to be interviewed.

Senator D'AMATO. I understand that. It has been widely reported that Arnold & Porter, your former law partners, are paying your legal fees in connection with your involvement in the case against Southland. No. 1, is that true?

Mr. FEDDERS. That is true. It is reported in my written statement. I chose not to follow up orally with the details. It is reported

at pages 29 and 30 with a footnote in my written statement under what we call chapter 18 of my report. It is true. It has been reported in the press.

Senator D'AMATO. Do you see any possible conflict in connection with this?

Mr. FEDDERS. I do not. When I testified before the House of Representatives in executive session in September, I was asked the question whether or not I was paying the fee, whether I intended to seek reimbursement from Southland, to which I said no. Whether the SEC is in fact going to pay Mr. Lewin, and I said no. But I did raise the prospect of Arnold & Porter's longstanding policy of paying the legal fees of partners, associates, or employees for events and circumstances that occur during the course of their employment.

After that hearing in September, I first wrote Myrna Siegel, the Commission's ethics counsel, on September 30. I am now paraphrasing from footnote 14 on page 30 of my written statement.

I later received a letter confirming the policy from David Kentoff of Arnold & Porter. I provided that to Mrs. Siegel. On November 8 Mrs. Siegel wrote me again. I then made a written request from the acting director of the Office of Government Ethics as to the propriety of this. He gave me a clean legal opinion on January 31, 1983, of the propriety of this.

And then, lo and behold, quite a surprise to me, Mrs. Siegel wrote me a memorandum April 18, 1983, and told me not only did I have the comfort of the Office of Government Ethics but the Office of Legal Counsel of the Department of Justice had concurred in that opinion of January 31.

After having received those opinions, Mr. Lewin had gone without pay for a number of months, I provided those opinions to Arnold & Porter. He provided them copies of his legal statement. Since that time, they have been paying Mr. Lewin's fees.

Senator D'AMATO. In light of the fact that you were formerly a partner of Arnold & Porter and they currently are paying your legal fees, how do you deal with a situation where Arnold & Porter represents clients before the SEC? If you have not had to face this situation at the present time, how would you deal with such a situation in the future?

Mr. FEDDERS. When I came to the Commission in July of 1981, I made a written declaration, which was approved by the ethics counsel, that I would not participate in Arnold & Porter matters until after January 1983 and I would re-review it at that time.

In light of the incident here where Arnold & Porter is paying my fee, I will recuse myself for the balance of the term at the Commission with regard to any matter Arnold & Porter is involved in. If I choose to stay in the Commission another decade or another two decades, that may become a burden. But that is my course of conduct at the present time. Myrna Siegel, the ethics counsel, and I have discussed that, and we have memorialized that.

Senator D'AMATO. It has been reported in the press, that you have scolded your staff for inquiring into the Ashland matter, saying, "Haven't I told you we aren't bringing questionable payment cases anymore?"

Also given the fact that you once specialized in handling these kinds of matters, does that indicate some kind of predisposition that you might have? Doesn't that bring about a situation where people may feel that the Commission would bring questionble-payment cases anymore?

Mr. FEDDERS. Mr. Chairman, there are six questions that I discern there. First of all, when the Ashland matter was raised with me, I made an intemperate statement. Unfortunately, from time to time I make intemperate statements. I regret that I made the intemperate statement.

Senator D'AMATO. I make them rather regularly, so——

Mr. FEDDERS. You are more honest in that respect than I am. You make them regularly. I make them very regularly. It is unfortunate that I made an intemperate statement to the staff under certain circumstances.

Let me tell you this, though, the persons attending that meeting were Ms. Hechinger, Mr. Horn, and Mr. Bragg. Once they spent a few minutes telling me about the course of conduct that they were investigating, within 10 minutes I got the lawyer back on the phone, by the name of Bernard Barnett, who had called me on the speaker phone in front of them, and I told him that the investigation was going forward.

I encouraged the staff at that time. I did not know that Arnold & Porter had some role in that matter. The full degree of Arnold & Porter's role I am now learning from the press reports that are coming out.

Was I intemperate? Yes. Did I know Arnold & Porter's role? No.

I then encouraged the staff to go forward, and I am told that I complimented them. This all occurred within a short period of time.

Senator D'AMATO. You are saying, so that we have a proper sequence of events, that you made this statement to the staff before they disbanded, and that after their giving an explanation to you, and details as to why they were conducting the investigation you reassessed you position, indicated that, indeed, given the circumstances, they should go ahead. then subsequent to that you called a certain lawyer.

Would you explain to me who that lawyer was and why you called him to tell him that you were going on with this case?

And also, are you are saying—that you had no knowledge of this investigation prior to this meeting with these people and you had no knowledge of who the law firm involved was?

Mr. FEDDERS. Let me run through it so that we are both clear.

Senator D'AMATO. Tell me who that lawyer is that you called. Who is the attorney that you called on the speaker phone to advise him that this matter was being pursued?

Mr. FEDDERS. His name is Bernard Barnett. Barney Barnett. He's a lawyer in the District of Columbia, who is a senior partner in the firm of Barnett & Alagia.

FIRST KNOWLEDGE OF ASHLAND INVESTIGATION

Senator D'AMATO. Why did you feel it was necessary to tell him that you were going forward with this?

Mr. FEDDERS. Because he is the chap that called me and told me about the staff conducting this Ashland investigation.

Senator D'AMATO. Oh, he called you and he said your staff is conducting this investigation?

Mr. FEDDERS. I don't recall specifically what he said to me.

Senator D'AMATO. He made it known to you for the first time?

Mr. FEDDERS. I believe it was the first time.

Senator D'AMATO. Is this the same day you met with the staff?

Mr. FEDDERS. Within a few minutes. I had some of the staff around me. This is the first time I learned of the Ashland investigation.

Senator D'AMATO. Then he called you and he told you this. Did you say anything to him?

Mr. FEDDERS. I don't recall. I don't recall that conversation. I don't know why I came out of that conversation with some of the staff and acted intemperately, or as the press reported, chastised the staff. I don't know what the exact words are. I don't recall what he said to me that caused me to be intemperate.

Senator D'AMATO. Maybe he advised you of an investigation that you weren't aware was taking place. Maybe you thought you just wanted to know what was going on.

Mr. Fedders. But the point is its important to know about these things.

Senator D'AMATO. Doesn't that jog your memory? This fellow calls you, Barney Barnett; I know him; he says to you—what did he say? Does he represent Ashland at this point? What did Barney Barnett say to you when he called? Also did he represent Ashland?

Mr. FEDDERS. It's my recollection that he said he represented Ashland or an individual. Remember, I am learning a lot more since that time from the newspaper accounts of that.

Senator D'AMATO. I understand that. I have been through this many times, you know.

Go ahead now, tell me.

Mr. FEDDERS. I can't tell you before he made this call in the fall of 1981 that I was unaware of the Ashland investigation. I came in July. I was comprehensively briefed on what I thought was every investigation in the office. It was done in a superb manner by the staff. I have no problem with that.

Barnett calls me this particular afternoon. I forget the date, but I am sure it is easily available. And the press has reported it. I hang up with him. I may have had another conversation or two in the meantime, but I summon the three individuals: Ms. Hechinger, Mr. Horn, and Mr. Bragg. They come into my office. I make an intemperate statement.

I then hear them out as to the several things that were under inquiry, one, two, three, four, five, whatever there were. I say to the staff, hold on.

Senator D'AMATO. Was he complaining basically about the investigation taking place?

Mr. FEDDERS. I don't recall, Senator. It's to my disadvantage that I don't.

Senator D'AMATO. All right. Go ahead.

Mr. FEDDERS. I listen to them. I am told by them that I complimented them. I didn't even recall until they told me—then I

checked my notes—that apparently I have a speaker phone to the left of my desk. I reach over, I tapped the speaker phone. Either Alice, my secretary, or I rung up Barney Barnett, had him on the speaker phone, said something to the effect—they are in the room; they can tell you "Hey, Barnett, this is much more than you told me. This investigation is going forward." Hung up from him, complimented the staff, and they went forward.

Now, it is some period of time that that——

Senator D'AMATO. I do those things some time too.

Mr. FEDDERS. Intemperance is not acceptable in the enforcement world.

Senator D'AMATO. You mean you cannot say to somebody, what are you doing, why are you bringing this or why aren't you? You mean that you don't think prosecutors do that everyday?

Mr. FEDDERS. If that's what I said, that wouldn't be so much intemperate. Apparently, I was much more intemperate.

Senator D'AMATO. Oh, really? You use the bad words too? [Laughter.]

Mr. FEDDERS. I didn't say anything particularly irreverent or disrespectful. I commented——

Senator D'AMATO. Did you ever kick the desk?

SEC DOES INVESTIGATE QUESTIONABLE PAYMENT CASES

Mr. FEDDERS. There is a dichtomy between what I think I said and what the staff reports I said. I think I said I don't want to spend my 3 years or 4 years here doing questionable payment cases.

Senator D'AMATO. That's important because there's an attitude that exists now that maybe the Commission isn't going to do questionable payment cases anymore. Is that true? I think you've answered the other questions to my satisfaction.

Mr. FEDDERS. Let's get to the important question. This is the most important question.

Senator D'AMATO. Wait. You may think it's the most important question. Are people to assume now that—we are condoning bribery? That's what people think. When you say questionable payments. Is the SEC going to say now that corporation can go ahead and do these things?

Mr. FEDDERS. That's not what we're saying at all.

Senator D'AMATO. Wait a second. I'll give you an opportunity to explain fully. I haven't cut you off. I don't think I have. I want you to understand that is a perception we deal with. Perception becomes reality, unfortunately, when it's in the media. So I'm suggesting to you, when people hear questionable payments, that the layman, the lay person, begins to think, oh, this administration is now saying everybody can pay people off. It seems the SEC is saying, don't worry about whether they put $10,000 in some guy's pocket.

Are we saying that?

Mr. FEDDERS. Mr. Chairman, we're not. Let me address that in several fashions. It is without question——

Senator D'AMATO. You're speaking to the general public now, as much to the chairman. You better understand that, because this is

important. You have got people who rightfully or wrongfully have a perception that says that the SEC, is not interested in bribery. Respond to this.

Mr. FEDDERS. OK. I think the perception is not only wrong, it's uninformed and improper. There is no question that I had considerable differences in philosophy with that of my predecessor, with regard to the disclosure of illegal conduct. Those pieces of philosophy and the differences were articulated by me and known to those who followed me before I came to the Commission.

On November 19, 1982, I delivered a speech before the Federal Regulation of Securities Committee of the American Bar Association when it was meeting in Washington, D.C. That speech was on the topic of the failure to disclose illegal conduct. That speech represents several things. It represents a careful analysis, including some 40 footnotes, with regard to the current state of the law regarding the disclosure of illegal conduct. It also includes my philosophy with regard to the disclosure of illegal conduct and sets forth in what I believe to be an affirmative manner a very aggressive law enforcement philosophy.

That speech has been so badly misinterpreted by the press that at the very session that I gave it, it had been reported in the press that morning—and several of the lawyers in the room, who are the most sophisticated in the Federal securities laws, stood up and chastised members of the press by saying they had misreported it that morning. There has never been a careful reflection on what this speech says. This speech is a prolaw enforcement speech. We are engaged in the business of enforcing the federal securities law. We are not in charge of bribery, payoffs, and kickbacks, but if those things happen to violate the Federal securities laws in a material effect and affect disclosure or the integrity of management, we're going to be aggressive in our law enforcement.

That speech in its very outset sets forth five factors of philosophy in this area. I don't think anyone can dispute those. A few days before I gave this speech in October of 1982, Bevis Longstreth, one of the Commissioners, gave a speech different in words but substantially similar in philosophy. He has said publicly that he substantially agrees with my statement. Barbara Thomas, after I gave this statement, wrote me a personal memorandum telling me she agreed with the philosophy in the memorandum. I don't know what Chairman Shad's position on my speech is. I know he read it before I gave it. I don't know what Commissioner Evans' philosophy is, or Commissioner Treadway's philosophy is in this area. This is my own philosophy. I think it is prolaw enforcement, but it's a careful analysis.

Some of the things that were said in the 1970's with regard to the disclosure of illegal conduct can no longer be said, because the courts no longer support that theory and rationale. This is a heavily documented speech with regard to the current state of the law with regard to these disclosures and mine.

Let me tell you what the five pieces——

Senator D'AMATO. I like to see you speak with such emotion and passion, because I believe people who do that are sincere, and are not attempting to craft something to cover up. And I am going to give you a chance to answer the five things.

Again, what do we say, to those people, critics and the general public who might believe that the SEC is turning its back on bribery, corporate bribery?

Mr. FEDDERS. It's just not true. If the event and circumstances——

Senator D'AMATO. Let's say it again.

Mr. FEDDERS. It's just not true.

Senator D'AMATO. OK. Now you give me your five points.

FIVE FACTORS ON CORPORATE BRIBERY

Mr. FEDDERS. In this speech, there is an lengthy analysis that goes on for numerous pages. There are five points that I made.

First, I had five propositions. First, that the Commission should begin enforcement actions where failure to disclose unlawful conduct violates quantitative standards of materiality. I said illegal conduct may have material adverse economic consequences for a corporation that reasonable investors would consider important in making investment or voting decisions. However, conduct that violates Federal, State or foreign law may be, but is not necessarily, material information affecting investors.

Second, the Commission should initiate enforcement actions where there is a failure to disclose self-dealing or conflict of interest transactions. Shareholders have a special interest in information relating to the loyalty and honesty of directors and senior officers, in their dealings with the corporation to which they owe a fiduciary duty.

Third, the Commission should commence enforcement actions where there is a failure to disclose information mandated by the disclosure requirements of the Commission's rules for proxy materials, periodic reports or registration statements, particularly facts about director or senior officer conduct. By its enforcement efforts, the Commission must preserve the integrity of the line item disclosure requirements.

Fourth, the Commission should begin enforcement action when untrue statements of material fact are made or statements made or rendered misleading by the omission of material facts. Issuers must be held accountable for materially misleading statements in disclosure documents.

And fifth, and finally, absent the foregoing circumstances, the Commission generally should not utilize the antifraud provisions of the securities laws for law enforcement where there is a failure to disclose conduct which may be considered qualitatively material. The antifraud provisions of the securities laws work well in the areas of quantitative materiality, because disclosure and enforcement decisions can be related to the benchmark of earnings, assets or liabilities. There also are guideposts in the other areas I have mentioned. In contrast there are no benchmarks of general application in the area of qualitative materiality.

Now it is not an accident that I bring this speed. You did not request or your staff request that I bring this statement. I just want you to know I take this speech everyplace I go, with me.

Senator D'AMATO. I think it's important that people understand and know, that our staff did not give Mr. Fedders, any indication of any of the questions that would be asked of him. Obviously, he is a learned man who understood the nature of some of the allegations. He has already been subjected to testifying in an executive session with my colleagues in the House. So he obviously understood the nature of where the inquiry would center. But I think it is important that that be underscored.

Mr. Fedders, I appreciate your appearance and your willingness to answer all the questions in the depth and the detail and, yes, even with emotion. I look forward to analyzing any other letters and documentation that you might have, in terms of the retention of final documents.

As I said, initially, I think that you are the expert brought in from a prestigious firm, who was assigned this task at best or on an occasional basis to advise the in-house investigation. Unfortunately, it's my belief that that investigation was, at the very least, mishandled. The question as to whether or not they did it deliberately or whether or not it was just slipshod work, is something that you and I really cannot answer conclusively. We can, and reasonable people can intepret these events of differently.

This is an unpleasant task for all involved. So again I appreciate your testimony and your suggestions to committees at both the House and the Senate that you would be willing to come and testify under oath. The questions somewhat difficult, and this is an unpleasant matter.

I agree with your statement on page 33, and I quote, you hope that the prosecutorial authorities bring this matter to a conclusion, so that the public will be assured of the propriety of your conduct.

Again, I think it was absolutely essential that we hold this hearing. I will close the hearing. I don't know whether it will be necessary to convene another hearing. I don't believe it will.

While these procedings are not easy, they are necessary. So that people have an opportunity to see clearly what the record really is.

And so this committee stands in recess.

Mr. FEDDERS. Mr. Chairman, thank you for affording me this opportunity.

Senator D'AMATO. The committee is in recess.

[Whereupon, at 4:05 p.m., the hearing was adjourned.]

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